IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1630

CARL W. ANDERSON,

Petitioner,

—against—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JEROME J. LONDIN
Counsel for Petitioner
10 East 40th Street
New York, N. Y. 10016

INDEX

TABLE OF AUTHORITIES

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Carl W. Anderson, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on March 8, 1976.

Opinions Below

The United States District Court for the Southern District of New York denied Petitioner's motion to set aside the sentence of one year's imprisonment imposed on his conviction. The opinion of the District Court, printed in Appendix B, is reported *sub nom. United States* v. *Sloan,* 399 F. Supp. 982 (S.D.N.Y. 1975).

The United States Court of Appeals for the Second Circuit affirmed the judgment against Petitioner. The opinion of the Court of Appeals, printed in Appendix A, has not yet been officially reported.

Jurisdiction

The judgment of the United States Court of Appeals for the Second Circuit was entered on March 8, 1976. A timely application for rehearing was made in the Court of Appeals on March 22, 1976. The Court of Appeals denied the motion on April 7, 1976. The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1).

Questions Presented

1. Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78ff(a), the statute's penal provision, forbids the imposition of a jail sentence where the defendant had no knowledge of the rule he violated.

Where the conviction arose from the making by others of false business records in violation of Rules 17a-3 and 4, 17 C.F.R. §§240.17a-3, 4, promulgated by the SEC under authority delegated by Section 17(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78q(a)[1]—rules of which petitioner was concededly ignorant—and the filing by independent auditors with the SEC of a report (Form X-17A-5) required not by the Exchange Act itself, but by Rule 17a-5, 17 C.F.R. §240.17a-5, promulgated thereunder by the SEC pursuant to delegated authority, a rule of which petitioner

[1] Amended by P.L. 94-29, 89 Stat. 97 *et seq.*

was concededly ignorant, did the Court of Appeals correctly construe Section 32(a) in holding that imprisonment is permitted?

2. Where the indictment tracked only part of the language of Rule 8c-1(a)(3), omitting an essential part thereof, but tracked no other part of Rule 8c-1's language, and there was also a failure to prove or to instruct the jury as to Rule 8c-1(a)(3) or any other part of Rule 8c-1, and the conviction was based on erroneous SEC "expert" testimony (over objection)—which petitioner was not allowed to controvert—that all hypothecation of customers' securities was forbidden by Rule 8c-1,

(a) Did the Court of Appeals err in a crucial respect in reading the relevant part of Rule 8c-1(a)(3) when it said: "Rule 8c-1, 17 C.F.R. §240.8c-1, prohibits the hypothecation of securities, in language similar to that of 15 U.S.C. §78h(c)",[2] which delegates to the SEC the authority to promulgate anti-hypothecation rules?

(b) Since there was nothing to "correct" in the absence of an illegal hypothecation, did the Court of Appeals erroneously affirm a conviction for a non-criminal act under the conspiracy count for failure to "correct" a hypothecation that did not violate the federal securities laws?

(c) Contrary to this Court's teaching in *Ex Parte Bain,* 121 U.S. 1 (1887) and *Russell* v. *United States,* 369 U.S. 749 (1962), and in conflict with two other circuits,[3] did the

[2] Subsection (c) has since been redesignated as subsection (b) by P.L. 94-29.

[3] *United States* v. *Panzavecchia,* 421 F.2d 440 (5th Cir. 1970); *Gaither* v. *United States,* 413 F.2d 1061 (D.C. Cir. 1969); *Van Liew* v. *United States,* 321 F.2d 664 (5th Cir. 1963).

Court of Appeals permit an indictment that did not inform petitioner of the specific charge to be amended by prosecutorial and judicial interpretation of and gloss on the grand jury's indictment in violation of the Fifth and Sixth Amendments and Rule 7(c), Fed. R. Crim. Proc.?

3. Were petitioner's rights under the Fifth Amendment's Due Process Clause and Grand Jury Clause violated by: (a) the Government's extensive exploitation in summation of its unexplained five-year pre-indictment delay, and (b) the Government's wilful failure to call before the Grand Jury an attorney whose testimony was not cumulative or privileged and who directly contradicted on a crucial issue the one witness without whom it concededly had no case before the Grand Jury and at trial?

4. Was petitioner's conviction for conspiracy to commit an offense against the United States supported by sufficient evidence?

Constitutional Provisions, Statutes and Rules Involved

The applicable constitutional provisions, statutes and rules are set out in Appendix C. Section 8(c) of the Securities Exchange Act of 1934, 15 U.S.C. §78h(c), was redesignated as subsection (b) by P.L. 94-29, which also rewrote Section 17(a), 15 U.S.C. §78q(a), and amended Section 32(a), 15 U.S.C. §78ff(a)—all effective June 4, 1975. All citations and quotations are to these statutes prior to P.L. 94-29.

Statement of the Case

Genesis of the Case

This case arose from the Wall Street debacle of 1969-70, during which approximately 100 New York Stock Exchange ("NYSE") member firms disappeared. It concerns one such brokerage house, Orvis Bros. ("Orvis") and its Form X-17A-5, the financial questionnaire submitted by Haskins & Sells ("H&S"), its independent auditors of 20 years, to the NYSE and the SEC on Oct. 16, 1969. Although the Goodbody, Walston and other failures made far greater incursions into the NYSE special fund, Orvis was singled out for criminal sanctions although the public lost nothing.

Bill Anderson ("petitioner") was convicted of conspiring, in violation of 18 U.S.C. §371, to violate 15 U.S.C. §78q(a) and Rules 17a-3, 4 and 5, 17 C.F.R. §§240.17a-3, 4 and 5, promulgated thereunder by the SEC, by making false records and filing a false report (X-17A-5) with the SEC. Notwithstanding his conceded ignorance of those rules, he was sentenced to jail for one year.

Anderson's Position at Orvis

Anderson joined Orvis in July 1966 as a 1% partner with an investment of $25,000 (2417).[4] In early 1968 he became head of corporate finance (115, 2419), which kept him away from Orvis about two-thirds of the time (578, 582, 1574, 2420-1). Anderson had no involvement with the back office (which handled record-making and reporting), a very technical field not understood by the heads of many brokerage houses (1112-13).

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[4] References to a number only are to the trial transcript.

Sloan was the most powerful partner (591). From January 1969 he had complete control over day-to-day operations. He was the boss (627-8, 728-31), in full control of the firm (857-8), and ran Orvis (1141). He was the top man in command (1157).

In early 1969, when Sloan acquired this power as managing partner, Anderson became chairman of the executive committee. The chairman's function was thereupon reduced by the committee from chief policy officer to implementing policy made by the committee, a change effected by one of the partners to limit Anderson's power (1607-12, 1688; Gov. Ex. 4, minutes of Mar. 20, 1969).

In Anderson's absence, in May 1969, the executive committee voted three new partners into Orvis (733, 828-9, 1635; Ex. AA, AO, AP).

On May 6, 1969, in Anderson's absence, the executive committee stripped him of his underwriting power by limiting his underwritings to those approved by managing partner Sloan, research partner Mezzetta, and financial partner Kilduff. Anderson could not act without their approval (588-90, 1622-7, 2429-30; Ex. I, p. 2, no. 7). While he was away, in June 1969, the executive committee discussed five new underwritings having nothing to do with him (1636-8, 2430-1; Gov. Ex. 57).

The Exaggeration of Orvis' Capital

The 1969 transactions involving false record-making were all barred by the statute of limitations.[5] They are relevant only because the results were included in the Oct.

[5] The indictment was filed Sept. 10, 1974. Counts 2 through 7 were dismissed on pre-trial motion as statute-barred.

16, 1969 Form X-17A-5. The Court of Appeals referred to the following:

A. Sale of Clinton Oil & Gas Units—Orvis Commissions in a $791,000 Customer Account[6]

Orvis sold $17,000,000 of the units in 1969, at a 6% commission—about $1,000,000 (177-9, 185, 2171-2, 2181). Orvis earned its commission when it made the sale (180-1),[7] and Clinton would pay as the money came in (2229-30). The money was payable: 10% on contract, 30% April 15th, 30% July 15th, and 30% October 15th (2229-30; Ex. AH).

In March 1969 Sloan told Kilduff to take the commission payable into profit and loss (187-8). It was proper to do this in the month of sale (629-30). Kilduff told Sloan that it should be charged against capital if not receivable within 30 days (190).[8] Anderson said nothing (191).

Contrary to the Court of Appeals, Anderson did not know "early in 1969", or at any other time, that the part of the receivable that was over 30 days was treated as current capital. The $797,100 receivable was placed on the books in a customer's cash account by Kilduff on his own. No one told him to do it (223-6). The entry was made by Kilduff on April 30th (632-3; Gov. Ex. 30), when Anderson was away (2426). Kilduff never said Anderson told him how to enter the receivable, nor did he say Anderson ever knew it had been entered in a customer's cash account.

[6] Charged in Count 2, dismissed on pre-trial motion under statute of limitations.

[7] The Court of Appeals erroneously said the commissions were unearned.

[8] By March 40% was receivable within 30 days—the 10% on contract and the 30% on April 15th.

Contrary to the Court of Appeals, even Kilduff did not try to hide from H&S the true nature of the receivable. On Aug. 5, 1969—before the H&S audit as of Aug. 31, 1969—Kilduff instructed Michael, Orvis' comptroller (879), to accrue only one-third of what was by then $900,000 of commissions receivable on the sale of the units. But Michael did not understand[9] and left $900,000 on the books instead of $300,000 (888-9, 894-6; Gov. Ex. 44, Ex. Z).

Had Michael followed Kilduff's written instructions there would have been no material error in the account, because $290,000 had actually been received and credited prior to August 31st (243-4, 712). Moreover, even with Michael's error, as of the August 31st audit 70%[10] of the commissions—over $700,000—was then payable and was properly computed in capital.

B. Transfer of Realto Clinton's Stock[11]

Contrary to the Court of Appeals, Anderson did not learn in September (or at any other relevant time) that Realto Clinton's stock was credited to this account; and, contrary to the Court of Appeals, it was not "wrongfully" done by those who did it. Kilduff and Eucker discussed it with Sloan in August 1969 (243-6, 253-4). Kilduff said he did not discuss it with Anderson (247).[12]

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[9] When Kilduff appointed Michael comptroller in the Spring of 1969, Michael said he was not qualified (879, 902-3).

[10] 10% on contract, 30% April 15th, and 30% July 15th were already receivable—obviously in less than 30 days.

[11] Charged in Count 4, dismissed on pre-trial motion under statute of limitations.

[12] Kilduff also testified that around September he had a conversation with Anderson *or* Villani (247-8), at which Kilduff "would bring out the various things that were used to prop up the capital."

This stock transfer was permitted under Realto Clinton's subordinated loan account, from which it was transferred. His subordinated loan agreement, Gov. Ex. 112, allowed the stock to be dealt with as partnership property, transferred, etc. (2242). Moreover, Orvis sent monthly statements to its subordinated lenders (252-6), and it was standard procedure for H&S to send him confirmations showing the transfer, including a letter of explanation. Clinton never disputed the transfer (650-2, 1364-71, 1373-5).

C. Salesmen's 40% Shares of Units Commission

Kilduff suggested not accruing commissions due to salesmen. Neither Anderson nor anyone else said anything (240-2). Accordingly, the Court of Appeals was mistaken in saying Anderson was aware of "[t]he decision not to deduct these commissions."

D. 4,344 Shares of Clinton Oil[13]

About March 3rd 4,344 shares of Clinton Oil were sent by Realto Clinton to Orvis (Gov. Ex. 38). Sloan said they were "for the partners." Over objection, Kilduff said he understood this to mean a purchase for a price he did not know (263-7). Anderson said nothing (267-8).

The stock was posted in the Orvis trading account on April 16th. Anderson had nothing to do with it (269-70, 272). The cost of the stock was posted in August and charged against capital prior to the arrival of H&S for its audit (294; Gov. Ex. 44). Kilduff told the executive committee the cost had been charged to the trading account and had hurt capital (296-8). The others said nothing (297).

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[13] Charged in Count 6, dismissed on pre-trial motion under statute of limitations.

E. 5,000 Shares of Clinton Oil[14]

In May Sloan received 5,000 shares of Clinton Oil from Realto Clinton. He gave them to Kilduff "for the partners." Eucker put the stock in the trading account without cost. Anderson was not present at any of these times (286-8). He was in Europe (2426). In August "this" was discussed. Anderson said nothing (289-90, 292).

F. $500,000 in Orvis Trading Account[15]

On August 19, 1969 an additional loss of $500,000 was found in the Orvis trading account by Kilduff's department. Kilduff told Sloan (337-40). Sloan reported it to the general partners meeting on August 20th, and there was an outcry to fire Kane, who ran the account. In answer, Sloan said that Orvis' relationship with Realto Clinton would be seriously impaired if Kane left, because Kane was very close to Realto Clinton and was important to his stock in which he made a market. Sloan said he had just phoned Clinton, who would wire $500,000 cash to Sloan personally as a loan to Sloan to add to the firm's capital (174-5, 340, 343, 344, 701-2, 697-9; Gov. Ex. 61).

Clinton sent $500,000 to Sloan before the end of August 1969. Sloan told Kilduff and Eucker it was not a loan to him, but part payment of the Units' commission receivable. Sloan told Kilduff to use it as capital. At Kilduff's suggestion it was put in the Kane trading account by Kilduff and Eucker. Anderson was not present at the discussions and had nothing to do with the entries (354-60). In early September Kilduff told the executive committee he had

[14] Charged in Count 7, dismissed on pre-trial motion under statute of limitations.

[15] Charged in Count 3, dismissed on pre-trial motion under statute of limitations.

put the $500,000 in the Kane trading account. Anderson said nothing (361-4).

G. 80,000 Shares of Clinton Oil[16]

Sloan was responsible for the sale by Orvis of the 80,000 shares to Clinton Oil (373-6, 380, 383, 722-4, 842-3). In September, in Anderson's presence, Kilduff and Eucker asked Sloan about payment. Sloan said Clinton would take care of it (383-4, 724). Kilduff thought it a good trade until May 1970 (724-5). Villani thought it was a good trade (2741). Anderson thought it was a good trade (2551-2).

Clinton had a real concern about Orvis' large position in Clinton Oil stock. When Gamelson (Clinton's general counsel) and Smith came to see Sloan on August 28th at Clinton's instructions (and were sent by a secretary to Anderson), a very important purpose was to check Orvis' inventory of Clinton Oil stock (1163-4) and to find out if Orvis was dumping the stock (1196, 1214). This was the first subject Gamelson and Smith discussed with Anderson, because Clinton had expressed concern, using the word "dumping", and was worried about large selling in the market by Orvis (1270-3).

Gamelson himself had 418,000 shares of Clinton Oil which sold at 30 during mid-1969 (1188, 1204-5, 1215), worth over $12,000,000 on paper. Clinton had over 1,000,000 shares (1215). The sale of 80,000 shares would depress the price by a couple of points at least (1115). If other brokers heard Orvis was dumping, they would lower their bid, depressing the value of the stock (1215-16). Clinton said Gamelson was more concerned than he was (2235-7). Gamelson had

[16] Charged in Count 5, dismissed on pre-trial motion under statute of limitations.

offered to put money into Orvis. Anderson refused and returned the stock Mr. and Mrs. Gamelson had offered to contribute as a subordinated loan (1164, 1193), which was 25,000 shares at 30 worth $750,000 (1211). As Gamelson said, Orvis controlled 600,000 to 700,000 shares at the time —probably more than anyone else—and Orvis was also very important to Clinton Oil, because Orvis was selling the drilling ventures (Units) and maintaining a very active market in the stock (1200-1).

H&S never received the spurious letter purporting to deny the trade—Gov. Ex. 108, received over objection (1173-6) and read to the jury (1175) on the prosecutor's representation that Clinton would say he sent it (1397). Clinton did not so testify. He could not recall (2197-9).

Vayda of H&S explained the procedure whereby exceptions to confirmation are logged, and said no exception was received for the 80,000 share trade—or, for that matter, in connection with Clinton's subordinated loan or the Units commission account 55-1400 (1364-71, 1373-5). He said Gov. Ex. 108 was not received by H&S (1372-3, 1375).[17]

H. Sale of International Controls Corp. Stock to Fund of Letters[18]

Anderson effected a cross in unregistered ICC stock between Hoffman and Bull, as sellers, and the Fund of Letters, as buyer, through a company named Viszcaya (the Goulandris Family) which was to acquire the sellers' unregistered stock and resell to the Fund at a higher price the same amount of Viszcaya's shares with registration rights (2468 *et seq.*). After a year of negotiations the Fund rejected the trade because ICC would not register the stock (505).

The indictment charged the transaction as part of a conspiracy to violate Reg. T. It was not charged as one of the numerous allegedly false entries in Orvis' records. Realizing in mid-trial that it was not a Reg. T violation, the prosecution over objection changed its theory, in effect rewrote the indictment, and charged it as part of the overall conspiracy to file false records with the SEC (2437-41, 3028), in that its dollar total was included in customers' cash accounts rather than customers' partly secured accounts.

Anderson had nothing to do with the way this 1968 transaction was recorded on Orvis' books under customers'

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[17] Gov. Ex. 108 is addressed to H&S at the post office box used for the 1969 audit confirmations—P.O. Box 246, Wall Street Station—indicating the Clinton entities had received the confirmation requests.

[18] Charged in Count 1 as part of a conspiracy to violate Reg. T, 12 C.F.R. §220, which allegation was stricken during the trial. The Fund of Letters is a public closed-end investment company, now known as New America Fund, which at the time specialized in the purchase of restricted or non-registered securities —i.e., letter stock, hence its name (1690, 1720-1).

The prosecutor who presented the case to the grand jury (not Government trial counsel) was ignorant of and misadvised the grand jury concerning Reg. T, when he questioned a witness about, *inter alia*, the Fund of Letters trade:

> "Q. Did you have any discussion with anyone concerning these accounts in which there were debit balances regarding possible Reg. T violations? A. No, sir.
>
> "Q. Do you know what a Reg. T is? A. Specifically, no; so you had better tell me.
>
> "Q. You have debit balances in certain accounts, customer accounts, which can be used as good capital for a certain period of time of upwards to thirty days, but thereafter certain balances should not be used in computing a firm's capital position. A. You said debit balance?
>
> "Q. Yes. A. No, I did not know that" (Gov. Ex. 3533 id.; C.A. App. 166a).

cash accounts—where it indeed belonged at the time. There was no testimony that Anderson at any time thereafter, when it became a disputed trade, discussed with anyone the place where the transaction should be recorded. Indeed, the prosecution established that at first Anderson discussed the transaction with no one at all, and that later the entire firm was aware of it and was after him. On the one occasion Kilduff claimed to have said—in the presence, *inter alia,* of Musil, Villani and Anderson (who all denied it)—that the four problem accounts (Bozeman, Martin, Aquarius and Fund of Letters) were not being charged against capital, Kilduff said: "I don't recall him [Anderson] saying anything at that particular meeting, sir" (309-10). And even then there was no discussion about where on Orvis' books the trade was recorded.

When H&S was told of it during the August 1969 audit, they made no change in the accounting treatment except to have Orvis double its reserve for uncollected customers' accounts.[19] Vayda of H&S knew of the four accounts—Fund of Letters, Bozeman, Aquarius, and Martin—and that they were carried as cash accounts, notwithstanding the fact that they "were, as we called it, in deficit, partly secured" (1327). Kilduff told Vayda "this was one of the exposure areas of Orvis Bros." (1328). Orvis' records showed the longstanding debits (492-3).[20] H&S took this into account and, after doubling the reserve, "left them [the four accounts, including Fund of Letters] in 'cash accounts'" (1328), footnoting Item 6-A of Form X-17A-5 as follows:

[19] One of the Big Eight with decades of experience, H&S had about 25 men directly involved in the audit and had been auditing Orvis for 20 years (393-4, 396, 493).

[20] The Fund trade date was Oct. 24, 1968, with an Oct. 31, 1968 settlement date (1722; Gov. Ex. 152).

> ". . . A reserve has been provided for accounts considered doubtful of collection; . . ."

Anderson should not go to jail for an accounting interpretation of a NYSE rule made by acknowledged experts who had audited Orvis for 20 years.

The H&S Audit and Review of Form X-17A-5

H&S had audited Orvis for 20 years (396). 25 of their men spent over 1,000 hours in the 1969 audit (393-4, 2340). Kilduff and Eucker were in charge for Orvis (395). When H&S arrived they said hello to Sloan and Anderson, after which they dealt with Kilduff and Eucker (396, 1320-1). The diary of the H&S partner in charge, Sturgis (Ex. BO) and his diary extracts (Gov. Ex. 74-B) contain no reference to petitioner anywhere (2341-5, 2357).

Form X-17A-5 was reviewed at a meeting of Oct. 15th attended by representatives of H&S and Orvis. The filing of this report—the only SEC report mentioned in the entire case by anyone—was the subject of a separate count of which petitioner was acquitted. "The [Trial Court's] charge [to the jury] on this count required a specific finding that the particular false filing had been within Anderson's reasonable contemplation." 399 F. Supp. at p. 985. The jury's acquittal of petitioner on the substantive false filing count evidenced its refusal to believe petitioner was even present when Form X-17A-5 was reviewed by Sturgis, Taggart and Vayda of H&S with Orvis.

The Government called Taggart and Vayda. Both testified that they along with Sturgis, the partner in charge (2338-9), attended for H&S (1387, 1322). Taggart said

Sloan, Eucker and Kilduff represented Orvis (1388-9). Vayda also named Sloan, Eucker and Kilduff, but could not say Anderson was present ("it could possibly be that it could have been [also] Mr. Villani *or* Mr. Anderson" (1362-3).[21]

The Government did not call Sturgis—the defense did. Sturgis had listed the Orvis participants—Sloan, Eucker and Kilduff—in his diary, Ex. BO. He also listed them in Gov. Ex. 74B, the extract from his diary prepared for the prosecution during its investigation. According to Sturgis, Anderson was not present (2344-5).

Only Kilduff placed Anderson at the meeting (412)—and he got one of the H&S participants wrong too, omitting Taggart and erroneously replacing him with one Petrillo (411), who had nothing to do with the 1969 audit (Ex. BN, 2339). Kilduff failed to attribute any statement to Anderson at the audit review.

Anderson was not at Orvis that day. He was at the World Series. He lived in Forest Hills and went directly to Shea Stadium from home. After the game he went to a meeting of Clinical Health Science, a company in New Jersey (2632-3).

Form X-17A-5 was sent by H&S not only to the SEC, but also to the NYSE (pursuant to its Rule 417) and various states (1323, 1326). Only the covers and certificates are different. Form X-17A-5, the questionnaire itself, does not mention the SEC. Compare Ex. BP (sent to the NYSE)

[21] See also, Tr. 1322 (in which petitioner unsuccessfully objected to allowing the jury to speculate about his presence), 1323, 1358-60a. Vayda could not recall the specifics of the review (1375-8, 1380-1).

with Gov. Ex. 74 (the same questionnaire sent to the SEC, as permitted by Rule 17a-5(c)(1), 17 C.F.R. §240.17a-5(c)(1)).[22]

REASONS FOR GRANTING THE WRIT

I.

A jail sentence may not be imposed under Section 32(a), 15 U.S.C. §78ff(a), for filing a report required by an SEC rule of which a defendant is ignorant. Accordingly, petitioner's conspiracy sentence of imprisonment is illegal.

Petitioner was convicted of conspiring, in violation of 18 U.S.C. §371, to violate 15 U.S.C. §78q(a) and Rules 17a-3, 4 and 5, 17 C.F.R. §§240.17a-3, 4 and 5, promulgated thereunder by the SEC, by making false records and filing a false report with the SEC. He was sentenced to one year's imprisonment under the penal provision of the Securities Exchange Act of 1934, 15 U.S.C. §78ff(a).

That is what the original indictment charged in Count 1, paragraphs 4 and 5 (App. 11a).[23] That is what the ex-

[22] Rule 17a-5(c)(1) provides in pertinent part:

"(1) Any member, broker, or dealer who is subject to the provisions of paragraph (a) hereof may file in lieu of the report required by that paragraph a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member, or with any agency of any State as a condition of doing business in securities therein: . . ."

[23] References App. are to petitioner's appendix in the Court of Appeals. Paragraphs 4 and 5 read:

"4. It was further a part of said conspiracy that said defendants and their co-conspirators unlawfully, wilfully and knowingly would, directly and indirectly, make, keep and preserve and cause to be made, kept and preserved false and fraudulent books,

purgated indictment charged in identical language in paragraphs 3 and 4 as the sole paragraphs under the heading "Objects of The Conspiracy" (App. 24a-25a). That is how the Trial Court charged the jury (App. 82a-83a; 3027-8, Pet. 2d Cir. Br. fn. at pp. 36-7).[24] That is precisely what the Trial Court said in denying petitioner's motion to set aside his jail sentence. *United States* v. *Sloan*, 399 F. Supp. 982 at 982-3 (Appendix B). And Rules 17a-3, 4 and 5, 17 C.F.R. §§240.17a-3, 4 and 5 are specified in petitioner's judgment and commitment order (App. 259a).

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accounts and other records of Orvis which purported to reflect the true, accurate and current financial condition of Orvis, when in truth and in fact as the defendants well knew, said books, accounts and other records were materially false and fraudulent, in contravention of Rules 17a-3 and 17a-4 (17 C.F.R. Sections 240.17a-3 and 240.17a-4), rules prescribed by the S.E.C. as necessary and appropriate in the public interest and for the protection of investors.

"5. It was further a part of said conspiracy that said defendants and their co-conspirators unlawfully, wilfully and knowingly would, directly and indirectly, make and cause to be made false and misleading statements in applications, reports and documents required to be filed with the S.E.C., which statements were false and misleading with respect to a material fact or facts, in contravention of Rule 17a-5 (17 C.F.R. Section 240.17a-5), a rule prescribed by the S.E.C. as necessary and appropriate in the public interest and for the protection of investors."

[24] "The only crime charged is that these defendants are claimed to have kept false records and to have filed false reports, to conceal their imminent or actual insolvency.

What, then, is the particular section of the securities laws which defendants are charged with violating and with having conspired to violate?

It is a section of the 1934 Act which provides in pertinent part as follows:

'Every broker or dealer'—and obviously the firm of Orvis Bros. was a broker and dealer—'shall make, keep, and preserve such accounts, correspondence, memoranda, papers, books and other records and make such reports as the Securities and Exchange Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors.'

The principal SEC regulation with which we must concern ourselves is the one requiring brokers, such as Orvis Bros., periodically to file a questionnaire—that is what is called—setting forth certain specified financial information."

In the face of the foregoing and particularly the Trial Court's finding that petitioner was convicted of violating 15 U.S.C. §78q(a) and Rules 17a-3, 4 and 5 promulgated thereunder, rules of which he was concededly ignorant,[25] there can be no support for the Government's claim, accepted by the Court of Appeals, that petitioner's conviction is based solely on 15 U.S.C. §78ff(a).

With respect to Rules 17a-3 and 4 (record-making), there was no claim that petitioner made or kept the false records. With respect to Rule 17a-5 (SEC report), in a record of 3,000 pages of testimony and approximately 160 Government exhibits and 70 defense exhibits, there is no evidence that petitioner ever mentioned the SEC or that the SEC was mentioned in his presence.

Anderson was sentenced under Count 1, the conspiracy count. 18 U.S.C. §371 provides in pertinent part:

> "If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor."

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[25] "We may observe, however, that if this conclusion should be found erroneous, we would find no persuasive reason for disbelieving Anderson's testimony that he had been unaware of the specific requirements of 17 C.F.R. §240.17a-3, 4, and 5. Indeed, the verdict of acquittal on the substantive count may have been based on the jury's acceptance—at least to the extent of creating a reasonable doubt—of Anderson's testimony in this general regard. The charge on this count required a specific finding that the particular false filing had been within Anderson's 'reasonable contemplation.'" 399 F. Supp. at p. 985, Appendix C.

To determine whether "the offense, the commission of which is the object of the conspiracy, is a misdemeanor only," we must look to 18 U.S.C. §1, which provides:

> "Notwithstanding any Act of Congress to the contrary:
>
> "(1) Any offense punishable by death or imprisonment for a term exceeding one year is a felony.
>
> "(2) Any other offense is a misdemeanor.
>
> "(3) Any misdemeanor, the penalty for which does not exceed imprisonment for a period of six months or a fine of not more than $500 or both, is a petty offense."

Because Anderson concededly had no knowledge of Rules 17a-3, 4, and 5 (the rules he was convicted of conspiring to violate), under 15 U.S.C. §78ff(a) he could not be imprisoned for a substantive violation of such rules, but could only be fined an amount not to exceed $10,000 because that section then provided in pertinent part:

> " . . . shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." [26]

Under the sentencing provisions of §78ff(a), as to Anderson, "the offense, the commission of which is the object of the conspiracy, is a misdemeanor only," as defined in 18 U.S.C. §1; and under 18 U.S.C. §371 "the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor"—a fine of $10,000.

[26] P.L. 94-29 increased the maximum jail sentence to five years.

However, accepting the Government's contention, the Trial Court upheld the jail sentence it imposed on the erroneous theory that petitioner

> "was accused and convicted of conspiring to violate 15 U.S.C. §78q(a) which makes it a crime to make and file false and inaccurate records and documents • • • The 'no knowledge' proviso was not intended to permit one who knowingly conspires to violate the general standard of conduct set forth in 15 U.S.C. §78q(a) to claim protection on the ground that he did not have knowledge of some specific rule or requirement promulgated thereunder." 399 F. Supp. at pp. 984-5.

The Court was wrong. §78q(a) provides in substance that certain entities are required to keep such records and to make such reports as the SEC may prescribe by its rules and regulations. Other than to set forth in general terms the types of documents which the SEC may by its rules and regulations require to be kept, the section imposes no requirement whatsoever on any of the entities within its ambit. Furthermore, §78q(a) does not specify any report that is required to be made, other than those which the SEC may require by its rules and regulations. Finally, §78q(a) does not itself make any conduct unlawful, nor does it impose any penalty whatsoever. Contrary to the Court's opinion, it makes nothing "a crime", nor does it contain "a general standard of conduct."

Predictably, in the Court of Appeals the Government abandoned the theory it had successfully pressed on the

Trial Court, now arguing with equal success that petitioner's jail sentence was legal because he had violated, not an SEC rule, but 15 U.S.C. §78ff(a) itself by filing a false report. The argument does not survive a reading of §78 ff(a).

The penalty provision for violation of the 1934 Act is set forth in 15 U.S.C. §78ff(a), Securities Exchange Act of 1934, Section 32(a). It makes unlawful, and prescribes the punishment for, violations of the 1934 Act and any rules or regulations promulgated thereunder the violation of which is made unlawful or the observance of which is required under the terms of the Act.

The Court of Appeals misread §78ff(a)[27] in holding that its "no knowledge" proviso is inapplicable to all false reports. The section deals with two broad classifications of reports: (1) those reports required to be filed expressly by the statute itself ("this chapter"); and (2) those reports required to be filed by "any rule or regulation thereunder". Where the report is expressly required by the statute itself—Congressional enactment, as opposed to SEC fiat —the "no knowledge" proviso is concededly inapplicable.

[27] "§78ff. Penalties

"(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be . . . but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation." (Prior to P.L. 94-25 amendment.)

However, where, as here, the report is required by a rule or regulation—SEC fiat, as opposed to Congressional enactment—the "no knowledge" proviso is applicable.

The legislative history of the 1934 Act contains clear and frequent references to Congress' intention that the "no knowledge" proviso of Section 32(a), 15 U.S.C. §78 ff(a), was its way of ruling out imprisonment for a crime created by the SEC's administrative fiat, albeit under Congressional authority to promulgate "rules and regulations necessary and in the public interest for the protection of investors".

Accordingly, a prison sentence may be imposed for the violation of §78ff(a) arising from the false filing with the SEC of a report expressly required by "this chapter". Examples of reports expressly required by statute (as opposed to SEC rule or regulation), where only the *form* of the reports are left to the SEC, are: current and annual reports, required of certain publicly-held corporations by Section 13(a) of the 1934 Act (15 U.S.C. §78m(a)); and reports of transactions in the securities of certain publicly-held corporations by its "insiders", required by Section 16(a) of the 1934 Act (15 U.S.C. §78p(a)). See, e.g., *United States* v. *Colasurdo*, 453 F.2d 585 (2d Cir. 1971), *cert. denied*, 406 U.S. 917 (1972), which involved, *inter alia*, convictions for filing false current and annual reports.

On the other hand, where the conviction under 15 U.S.C. §78ff(a) arises from the filing with the SEC of a report nowhere referred to in the 1934 Act, but required only by a rule or regulation promulgated by the SEC pursuant to authority delegated by Congress, then the "no knowledge" proviso is applicable, and a prison sentence may not be

imposed when the defendant had no knowledge of the applicable rule or regulation.

In Anderson's case the report (Form X-17A-5) is required only by Rule 17a-5, 17 C.F.R. §240.17a-5, and is nowhere mentioned in the statute. Indeed, in pertinent part the indictment charged a conspiracy to file a false report with the SEC, "in contravention of Rule 17a-5 (17 C.F.R. Section 240.17a-5)" (App. 25a). The Court found Anderson had no knowledge of the rule (App. 256a-257a). Accordingly, the prison sentence was illegal.

No reported case has been found authorizing imprisonment for a false SEC report required by a rule of which a defendant was ignorant. In construing a criminal statute any ambiguity should be resolved in favor of lenity. *United States* v. *Bass*, 404 U.S. 336, 347 (1971).

It is fundamental that where an act of Congress prohibits a generic class of conduct but explicitly delegates to an administrative agency the power precisely to define the scope of the prohibition by rule or regulation, the conduct which is prohibited and thus punishable under the statute (if made criminal by the statute) is that defined by the rule or regulation. See, *United States* v. *Mersky*, 361 U.S. 431, 437-438 (1960); *M. Kraus & Bros., Inc.* v. *United States*, 327 U.S. 614, 622 (1946); *United States* v. *Pincourt*, 167 F.2d 831, 833 (3d Cir. 1948); *United States* v. *Morgan*, 118 F. Supp. 621, 696 (S.D.N.Y. 1953); *Securities and Exchange Commission* v. *Otis & Co.*, 18 F. Supp. 100, 103 (N.D. Ohio 1936), *aff'd*, 106 F.2d 579 (6th Cir. 1939); *United States* v. *Hark*, 49 F. Supp. 95, 97 (D. Mass. 1943), *rev'd on other grounds*, 320 U.S. 531 (1944); and compare *United States* v. *Pennsylvania Industrial Chemical Corp.*, 411 U.S. 655 (1973).

In *Kraus, supra,* the Supreme Court reversed the conviction of a defendant who was charged with violating the Emergency Price Control Act of 1942 (50 U.S.C. Appx. §§901 *et seq.*) and the regulations promulgated by the Price Administration thereunder. In determining the scope of the statute which punished a "violation of any regulation" promulgated by the Administrator, Mr. Justice Murphy wrote as follows (*id.*, 327 U.S., at 622):

> "The prohibited conduct must, for criminal purposes, be set forth with clarity in the regulations and orders which he [*i.e.*, the Administrator] is authorized by Congress to promulgate under the Act. Congress has warned the public to look to that source alone to discover what conduct is likely evasive and hence to create criminal liability."

II.

The indictment failed to allege the essential elements of an illegal hypothecation, and there was no proof of one. After a conviction based on the Trial Court's erroneous holding that any hypothecation of customers' securities violates Rule 8c-1, 17 C.F.R. §240.8c-1, the Court of Appeals erroneously affirmed petitioner's conviction for a non-existent crime under the conspiracy count—failure to "correct" a hypothecation that did not violate the federal securities laws, and in violation of the Fifth and Sixth Amendments and Rule 7(c), Fed. R. Crim. Proc.

The indictment charged, *inter alia*: a substantive violation of the SEC's anti-hypothecation Rule 8c-1, 17 C.F.R. §240.8c-1, promulgated pursuant to authority delegated by Section 8(c) of the Securities Exchange Act of 1934, 15

U.S.C. §78h(c);[28] a substantive violation of the reporting Rule 17a-5, 17 C.F.R. §240.17a-5, in that the illegal hypothecation was falsely claimed to have been corrected; and a conspiracy to violate Rule 8c-1 and Rule 17a-5.

The indictment tracked part of the language of Rule 8c-1(a)(3), but erroneously omitted the crucial words, namely, that the lien on the pledged securities was "for a sum which exceeds the aggregate indebtedness of all customers in respect of securities carried for their accounts." No other language of the Rule 8c-1 was mentioned. Pretrial, trial and post-trial motions attacking the insufficiency of the indictment and evidence in this regard were uniformly denied.

Notwithstanding the Government's contention that the illegal hypothecation was "the most successful way" petitioner "agreed to hide the red and bleak financial picture of Orvis Bros. from the SEC"[29] and that it was "the crux of the questionnaire" [Form X-17A-5] . . . the biggest single item" (1096), the Government's proof showed Anderson did not know of the allegedly illegal hypothecation before Form X-17A-5 was filed by H&S, and the Trial Court found that hypothecation was "not within the contemplation . . . of the conspiracy" (417, 2310-11).

As submitted to the jury, the theory of the prosecution was that this illegal but inadvertent hypothecation, which was unknown to Anderson, was falsely claimed to have been corrected. That is how "since corrected" was construed—namely, that all hypothecation of customers' se-

[28] Redesignated a subsection (b) by P.L. 94-29, effective June 4, 1975.

[29] Government's Opening, 4/3/75, Transcript meh 15-17.

curities is "stealing" (2311), regardless of all customers' aggregate indebtedness; and that if any customers' free securities remained as collateral for Orvis' bank loans, regardless of the sum of the aggregate indebtedness of all customers, then the amount of the erroneous pledge had not been corrected.[30]

The Government was not required to prove that the amount of customers' securities pledged in error had not been corrected when Form X-17A-5 was filed, in that the lien still exceeded the aggregate indebtedness of all customers. And Anderson was not permitted to show that the amount of customers' securities pledged in error had in fact been corrected when Form X-17A-5 was filed, because the lien did not exceed the aggregate indebtedness of all customers.[31]

[30] Available data demonstrates that the practice of pledging fully paid for securities is common:

CUSTOMERS' FULLY PAID FOR SECURITIES PLEDGED BY BROKERS AND BANKS

Firm	*Customers' Fully Paid Securities Pledged*
Merrill Lynch	$ 3,482,986
Bache	24,896,949
duPont, Glore Forgan	19,850,736
Goodbody	18,957,886
Hornblower	10,298,936
Paine, Webber	1,909,741
Walston	5,049,415
E. F. Hutton	2,519,269
Hayden, Stone	173,668
Dean Witter	303,431
Total	$87,443,017

See, Baruch, H., WALL STREET—SECURITY RISK, p. 36, Acropolis Books, Ltd., Wash., D.C. (1971).

[31] Indeed, the Government's evidence established that the total of the liens of pledgees on customers' securities *did not exceed*

Indeed, an SEC "expert" erroneously testified for the Government that: "It is rather a rule not to pledge customers' securities with banks. It is a rule of the New York Stock Exchange and a rule of the Securities and Exchange Commission" (1934), referring specifically to the SEC's Rule 8c-1 (1937). Anderson was barred from cross-examining on this subject on the ground that it was a previously-decided question of law (1937-9).

Section 8(c) of the 1934 Act, 15 U.S.C. §78h(c),[32] makes it unlawful, *inter alia,* for any broker or dealer:

> *"In contravention of such rules and regulations as the Commission shall prescribe* for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer under circumstances • • • (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities." (Emphasis supplied.)

Pursuant to the authority delegated by the statute, the SEC promulgated Rule 8c-1 (17 C.F.R. §240.8c-1) which defines the conduct made unlawful. The pertinent provisions of Rule 8c-1 are as follows:

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the aggregate indebtedness of all of the customers in respect of securities carried for their accounts. Gov. Ex. 74 and Ex. BP (Form X-17A-5) demonstrate that the total amount of Orvis' borrowings ($18,521,300.00) was less than the aggregate indebtedness of all of its customers on securities carried for their accounts ($21,398,719.14).

In response to a request for particulars as to "the aggregate indebtedness of all of Orvis Brothers & Co. customers in respect of securities carried for their accounts at the time of the alleged hypothecation," the Government stated that the request was "irrelevant and immaterial", and the particulars were denied.

[32] Redesignated as subsection (b) by P.L. 94-29.

> "(a) General Provisions.—No member of a national securities exchange, and no broker or dealer who transacts a business in securities through the medium of any such member shall, directly or indirectly, hypothecate or arrange for or permit the continued hypothecation of any securities carried for the account of any customer under circumstances—
>
> • • • • •
>
> "(3) that will permit securities carried for the account of customers to be hypothecated, or subjected to any lien or liens or claim or claims of the pledgee or pledgees, *for a sum which exceeds the aggregate indebtedness of all customers in respect of securities carried for their accounts;"* (Emphasis supplied.)

It is plain that the statute (15 U.S.C. §78h) by itself prohibits no specific conduct or act, but makes unlawful only the "contravention of such rules and regulations as the Commission shall prescribe." Although Section 8(c) of the 1934 Act, 15 U.S.C. §78h(c),[33] arguably would permit the enactment of an SEC rule proscribing the hypothecation of a particular customer's securities for a sum greater than the aggregate indebtedness of that customer on those securities, the existing SEC rule—which defines the only conduct made unlawful by Section 8(c) of the Act—does not do so. The SEC rule only limits the *total* amount which can be borrowed on customers' securities in relation to the *total indebtedness* of *all* customers of a member firm on *all* of their securities. It is only when the hypothecation is "for a sum which exceeds the aggregate indebtedness of *all* customers in respect of securities carried for their accounts" that there is a contravention of the rule prescribed by the

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[33] Now subsection (b).

Commission and a violation of the statute. In this regard, the rule whose violation is made a crime permits hypothecation to a far greater extent than its enabling §78h. The Court of Appeals erred in a crucial respect in reading the relevant part of Rule 8c-1(a)(3) when it said: "Rule 8c-1, 17 C.F.R. §240.8c-1, prohibits the hypothecation of securities, in language similar to that of 15 U.S.C. §78h(c)."

In commenting on present Rule 8c-1 and certain proposed changes to it, Ezra Weiss, counsel to the New York Regional Office of the Securities and Exchange Commission wrote in REGISTRATION AND REGULATION OF BROKERS AND DEALERS, p. 95, n. 5 (BNA, 1965):

> "Paragraph (a)(3) of the rule. The Commission has under consideration the recommendation of the *Special Study Report* for rules requiring a 'reasonable relationship' between the amount of each customer's securities that can be hypothecated or lent by a broker-dealer and the amount of the particular customer's indebtedness. (Citations omitted.) *The present rule is a restriction on the overall amount which can be borrowed on customers' securities in relation to aggregate indebtedness of all customers.*" (Emphasis supplied.)

The proposed rule change was never implemented and another proposed amendment, which would require a customer's specific written authorization given for fair and adequate consideration for the pledge of his fully paid securities, has been pending since 1961. SEC Release 34-9388, Nov. 8, 1971, 2 CCH Fed. Sec. L. Rep. ¶22,422 at pp. 16,306-9. See proposed Rule 8c-1(a)(4) and (5) at p. 16,307.[34]

[34] Notwithstanding the extensive amendments and revisions to the federal securities laws effected by P.L. 94-29, effective June 4, 1975, no such change in Rule 8a-1 has been promulgated.

See also, II Loss, L., SECURITIES REGULATION (2d Ed. 1961), in which Professor Loss distinguishes the New York provision dealing with hypothecation of customers' securities (former Penal Law §956, now General Business Law §339-e) as being in some respects more strict than §8(c) of the Exchange Act, and points out that unlike the New York statute the federal regulation does not prohibit the hypothecation of particular customers' fully paid for securities:

> "• • • Whereas Clause (3) of §8(c) speaks in terms of the aggregate indebtedness of all customers and makes the customer's consent irrelevant, the comparable New York provision prohibits the hypothecation of a *particular* customer's securities for more than the amount of the broker's lien on those *particular* securities *unless the customer consents*" (at p. 1200). (Emphasis as in original, footnote omitted.)

And V Loss (1969 Supp. to Vol. II), substituting a new note 41 to p. 1200 of Vol. II, states that "under §8(c)(3), theoretically, a broker-dealer owed $100,000 in margin accounts by all customers could hypothecate one customer's securities for that sum even though that one customer owed a much lesser amount" (at p. 3204).

Aside from the plain language of the statute which punishes only the contravention of the Commission's rules and regulations, Section 23(a) of the 1934 Act, 15 U.S.C. §78w(a), provides:

> "The Commission • • • shall • • • have power to make such rules and regulations as may be necessary for the execution of the functions vested in them by this chap-

ter • • • . No provision of this chapter imposing any liability shall apply to any act done • • • in good faith in conformity with any rule or regulation of the Commission • • • ."

Thus, the hypothecation of customers' securities—even if fully paid for—for a total amount less than the aggregate indebtedness of all customers on all of their securities is "in conformity with" Rule 8c-1 and cannot be violative of Section 8 of the 1934 Act, 15 U.S.C. §78h.

In a display of confession and avoidance, on appeal the Government conceded its error (Gov. Br. p. 70, footnote) but invoked the commingling provision, Rule 8c-1(a)(1), although it was not even charged in the indictment. The allegation of commingling does not appear in any form, nor by any fair construction can it be found within the terms of the indictment.[35] The matter was never even raised at trial; there was no proof that the securities of any named customer were commingled; and Anderson had no opportunity to defend against such charge.

This violates Anderson's Fifth Amendment right to have the Grand Jury consider the indictment, his Fifth Amendment right under the Due Process Clause, his Sixth Amendment right "to be informed of the nature and cause of the accusation", and the provisions of Rule 7(c), Fed. R. Crim. Proc., enunciated in *Ex Parte Bain,* 121 U.S. 1 (1887), *Russell* v. *United States,* 369 U.S. 749 (1962), and *Stirone* v.

[35] Indeed, when Anderson sought a bill of particulars with respect to hypothecation, the Government refused any particulars which would name any customer, the value of his hypothecated securities, and the amount of the lien placed thereon, successfully arguing its lack of materiality ("completely irrelevant" and "bereft of materiality").

United States, 361 U.S. 212 (1960). See also *United States* v. *Panzavecchia,* 421 F.2d 440 (5th Cir. 1970), *cert. denied,* v. *Panzavecchia,* 421 F.2d 440 (5th Cir. 1970); *Gaither* v. *United States,* 413 F.2d 1061 (D.C. Cir. 1969); *Van Liew* v. *United States,* 321 F.2d 664 (5th Cir. 1963).

The teaching of *Russell* v. *United States,* 369 U.S. 749, 765 (1962) is that an indictment may not merely track the language of the statute, but it must descend to particulars.

> "• • • it is not sufficient to set forth the offence in the words of the statute, unless those words of themselves fully, directly, and expressly, without any uncertainty or ambiguity, set forth all the elements necessary to constitute the offence intended to be punished; . . . Undoubtedly the language of the statute may be used in the general description of an offence, but it must be accompanied with such a statement of the facts and circumstances as will inform the accused of the specific offence, coming under the general description, with which he is charged."

Here the indictment only set out in part the language of subdivision (a)(3) of Rule 8c-1—which it now disclaims. *A fortiori,* under *Russell* it cannot rely on its mere recital in the indictment of the statutory and rule references, 15 U.S.C. §78h and 17 C.F.R. 240.8c-1, to contend after trial that it proved an unspecified commingling under another subdivision of the rule, or some other violation.

In sum, there was no proof that Rule 8c-1(a)(3) was violated, and Anderson was barred from showing it was not. Therefore, there was no proof by the Government that the customers' securities erroneously pledged had not been corrected by October 16, 1969. Moreover, commingling

violations, if any, may not support a conviction under *Russell*. Finally, the hypothecation subdivision in issue, Rule 8c-1(a)(3), permits far more extensive hypothecation than its enabling statute.

The Court of Appeals permitted an indictment that did not inform petitioner of the specific charge to be amended by prosecutorial and judicial interpretation. Since there was nothing to "correct" in the absence of an illegal hypothecation, the Court of Appeals erroneously affirmed a conviction for a non-criminal act under the conspiracy count for failure to "correct" a hypothecation that did not violate the federal securities laws.

The verdict was a general one of guilty, without special findings as to the acts on which it rests. Since it is not possible to identify the specification under which Anderson was convicted, the conviction must be set aside if any of the specifications submitted to the jury was insufficient. *Cramer* v. *United States,* 325 U.S. 1, 36, n. 45 (1945). The hypothecation specification ("since corrected") being legally insufficient, the conviction must be reversed.

III.

The Fifth Amendment's Due Process Clause and Grand Jury Clause were violated by the Government's extensive exploitation in summation of the unexplained almost five-year pre-indictment delay and its wilful failure to call before the Grand Jury an attorney whose testimony was neither cumulative nor privileged and who directly contradicted on a crucial issue the one witness without whom it concededly had no case before the Grand Jury and at trial.

The lengthy pre-indictment delay deprived Anderson of his Fifth Amendment right to Due Process. According to the indictment, filed on Sept. 10, 1974, the conspiracy began on Sept. 1, 1968. The overt acts were concentrated in the Spring and Summer of 1969 (outside the period of limitations). Although the Oct. 16, 1969 filing, the only overt act submitted to the jury, satisfied the statute of limitations by one month, the indictment should be dismissed because of the inexcusable and prejudicial pre-indictment delay.

There was simply no reason for the lengthy delay. By the Summer of 1970 Orvis, to the SEC's knowledge, was in liquidation and had sought aid from the NYSE special fund. Anderson testified before the NYSE on Oct. 23, 1970 and before the SEC on Sept. 22, 1971 and Oct. 1, 1971. Most SEC interrogations of witnesses and prospective defendants were completed in 1971, and the remainder were completed by mid-1972. Even Robert Vesco was interrogated on April 18, 1972 (App. 190a-191a). The case was referred to the Justice Department about 1½ to 2 years

before the grand jury testimony began in mid-July 1974 (623-5).

The Government's failure to call Peter Schmidt, Esq. as a witness before the Grand Jury violated the Due Process Clause of the Fifth Amendment as well as Anderson's Fifth Amendment right to indictment by a Grand Jury. On a crucial issue Mr. Schmidt's testimony directly contradicted Kilduff, the Government witness without whom there concededly would have been no prosecution case,[36] and it completely exculpated Anderson.[37] His testi-

[36] According to the prosecution:

"... Mr. Kilduff effectively made this case. Without his testimony there would have been no indictment and there certainly would not have been any case here at all." (Sentencing minutes, June 16, 1975, p. 29.)

[37] It is apparent from Kilduff's interrogation before the Grand Jury on July 18, 1974 (Gov. Ex. 3501 id., p. 40) that the Assistant had heard of Kilduff's statements to Peter Schmidt (App. 193a-194a):

"Q. Did you tell Peter Schmidt on that day, either during the course of your walk back to his office, or during the course of the luncheon, that you, in fact, had been responsible for the falsifications of the firm's books and records but that none of the other members of the Executive Committee were aware of what you had done and that you had done that out of a desire to save the firm? A. No. I knew, for instance, who else knew and was involved and whatnot in the months that we had gone through various transactions.

"I was fully aware that other members of the Executive Committee were fully aware of the various things that were spoke about today, so there would be no logic in my saying that to Peter Schmidt.

• • • • •

"But, no, I didn't tell Tom Shaw and/or Peter Schmidt that I was solely responsible for it. I might well have—I might well have spoken of the fact that we did this, or that why did I do that, or things of that nature. But in no way did I try to eliminate other members of the Executive Committee from the knowledge that they had."

mony was not merely cumulative or an alternative to permissible hearsay already before the Grand Jury as in *United States* v. *Koska,* 443 F.2d 1167, 1169 (2d Cir.) (per curiam), *cert. den.,* 404 U.S. 852 (1971), upon which the Court of Appeals relied in affirming.

Moreover, in affirming, the Court of Appeals stated that Mr. Schmidt's testimony "would have been, to a large extent, privileged." On the contrary, Kilduff, Mr. Schmidt's client, had waived all privilege when he testified in the Grand Jury on the very subject matter of the testimony the Government should have elicited from Mr. Schmidt before the Grand Jury. In addition, not knowing that Kilduff had waived the privilege, Mr. Schmidt offered to testify provided Kilduff waived the privilege (2624-5). The Assistant who presented the case to the Grand Jury did not inform Mr. Schmidt that Kilduff had waived the privilege and never called Mr. Schmidt as a witness.

The prosecutor should disclose to the Grand Jury any evidence which he knows will tend to negate guilt. ABA Standards Relating To The Prosecution Function And The Defense Function: The Prosecution Function, Section 3.6(b), at p. 88. (Mr. Schmidt's testimony went far beyond "tend[ing] to negate guilt"—it exonerated Anderson.) The failure to do so is a Fifth Amendment violation of the right to indictment by a Grand Jury. With respect to the Due Process Clause, it is analogous to a violation under *Brady* v. *Maryland,* 373 U.S. 83 (1963). See also, *Johnson* v. *Superior Court,* 124 Cal. Rptr. 32, 539 P.2d 792 (Cal. Sup. Ct. 1975) (concurring opinion at 539 P.2d, pp. 796-807).

The teaching of *United States* v. *Calandra,* 414 U.S. 338 (1974) is that: A federal prosecution for serious crimes

can only be instituted by a grand jury. The grand jury's responsibilities include the protection against unfounded criminal prosecutions. The scope of its powers reflects its special role in insuring fair and effective law enforcement, and it must determine whether criminal proceedings should be instituted against any person. When the grand jury is performing its investigatory function, society's interest is best served by a thorough and extensive investigation. A grand jury investigation is not fully carried out until every available clue has been run down and all witnesses examined in every proper way to find if a crime has been committed (at pp. 343-4).

If the foregoing is to be given meaning, an indictment based on the testimony of one co-conspirator witness may not stand, where there was a wilful failure to inform the grand jury of exculpatory evidence going to the credibility of that one witness on the essence of the case.

Extensive prejudice occurred at trial when in summation the Government unabashedly exploited its failure to call Mr. Schmidt before the Grand Jury and its unexplained 4 year, 11 month delay in prosecuting. The prosecution used the delay to dull the immediacy of Mr. Schmidt's testimony. Although aware of the exculpatory testimony he would give (fn. 37 *infra*), deliberately and for its own advantage (avoiding an attack on Kilduff's credibility, thus assuring an indictment and conviction), the prosecution failed to call him as a grand jury witness in its long-delayed investigation, thus combining delay with the pursuit of a prosecutorial advantage. This precluded an earlier written record of his sworn testimony favorable to Anderson, enabling the prosecution to dispute its weight in summa-

tion by contrasting it with Kilduff's much earlier-recorded testimony (NYSE in April 1971 and the grand jury in July, 1974), and concluding:

> "Who really knows exactly what was said in that crying sob scene in Schmidt's office five years ago or, excuse me, not five, three[38] years ago? Who can really say exactly what was said?" (2985).[39]

Relying heavily on the long unjustifiable delay that was solely the Government's responsibility, in summation the prosecutor exploited Anderson's prejudice by denigrating the defense for "nit-picking" when it cross-examined pros-

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[38] Actually, the event occurred on March 18, 1971—four years before Mr. Schmidt's testimony.

[39] Kilduff testified that Mr. Schmidt was an honorable man and that he had no reason to doubt his integrity or veracity (616). The testimony of Mr. Schmidt was:

> "He [Kilduff] said well, I will tell the truth but they won't believe me. He said, you heard what that guy said. They won't believe me if I tell the truth because I did it and I did it alone and he said, I want you to tell them that, I want you to tell Fergus and Bill that I did it, I did it because I tried to save the firm, I was sure that if we had some more time our net capital problems would have been solved, he said—he said they were too dumb to understand the net capital rules, that only he understood what they meant and how they worked, and that he had tried to phony up the records that were supplied to the Stock Exchange in order to save this firm and save his job, and that they didn't know about this and they didn't participate in it.
>
> "That is the substance of what he said" (2460-1).

Cross-examination of Mr. Schmidt by the prosecution is quoted in full:

> "Q. Mr. Schmidt, I take it during this entire conversation with Mr. Kilduff on this last day, the lunch and during this entire period that Mr. Kilduff was very upset and very emotional, is that a fair characterization? A. He was upset, embarrassed and emotional, I would say, yes" (2464).

ecution witnesses as to their memories of crucial dates and events "five, six, seven years ago" (2948, 2981-2). About Zalduondo, he said: "He is getting old. He doesn't remember things the way he might have used to remember them" (2995). About Mezzetta, who was precise on direct, the Court observed in curtailing cross-examination: "The man doesn't remember anything" (1876-8).

And there was Vesco who in 1972 was amenable to subpoena and testified before the SEC in its investigation of this case. Because of the delay, not only was his testimony unavailable, but the prosecution improperly and over objection repeatedly exploited his very name to prejudice Anderson (Opening, 4/3/75, Tr. meh 20-1; 127-8, 135-6, 141, 168, 230, 233, 281-5, 298-305, 313, 344, 549, 836, 1540-3, 1557-60, 1688-9, 1699-1701, 1760-4, 1775-7, 1818-19, 1838-40, 2670-2, 2674-5), e.g., "Carl Anderson was the major contact with Robert Vesco . . . It was through Mr. Anderson's efforts that Robert Vesco comes into O~vis Bros. . . . Carl Anderson goes out to California with Robert Vesco . . ." (Tr. meh 20-1); "Bill Anderson, who was very close with one of the limited partners, Bob Vesco" (549); inserting the name "Robert Vesco" where only "RV" appeared in a document read to the jury (1557-60).

Throughout his direct and cross-examinations Kilduff relied on a simple acronym to list those present at executive committee meetings when he claims improprieties were discussed—SAVE, for Sloan, Anderson, Villani and Eucker. When asked if others were present, he invariably said, "There could have been," thus precluding any direct attack on his credibility by Zalduondo, Mazzetta, and Musil —all of whom denied hearing what Kilduff claims to have said at any of the meetings they attended.

About Anderson's inability to corroborate his whereabouts on specific days in 1969, the prosecutor said:

> "You can attack Thomas Kilduff's recollection as you want. Mr. Anderson can take the witness stand until he is blue in the face and say on September 16 in Chicago, August 2, Denver, November 5, Kansas. *Who says? Carl Anderson says, that's all. No one else says so.* Carl Anderson flips through his diary and says here I was in Cincinnati. Here I was in New York. *Who says so except Carl Anderson*" (2983-4). (Emphasis added.)

And that is just the point. After so many years, who but the defendant is available? Should he be expected to span a continent and over half a decade to produce witnesses? The delay was purposeful; the substantial prejudice was exploited at trial by the prosecution. Anderson was denied his Fifth Amendment right to Due Process. The indictment should be dismissed. *United States* v. *Marion,* 404 U.S. 307 (1971). In *Marion* "the Government concede[d] that the Due Process Clause of the Fifth Amendment would require dismissal of the indictment if it were shown at trial that the pre-indictment delay in [that] case caused substantial prejudice to appellees' rights to a fair trial and that the delay was an intentional device to gain tactical advantage over the accused." *Supra,* at p. 324. Whether the delay was "an intentional device" necessitates inquiry into the state of the prosecution's collective mind. "The state of a man's mind," said Bowen, L.J. in *Edginton* v. *Fitzmaurice* (1885), 29 Ch. D. 459, 483, "is as much a fact as the state of his digestion." The intent may be seen in the failure to call Mr. Schmidt before the grand jury and in what the prosecution did at trial to exploit the delay.

However, even if the Court is persuaded of the Government's *bona fides* when it seeks to explain the delay, dismissal of the indictment is still required. In *Marion* the Court left open the "delicate judgment" as to "when and in what circumstances actual prejudice resulting from pre-accusation delays requires dismissal." *Supra,* at pp. 324-5. Where, as here, most of the events in issue are over-six years old, and the indictment was unjustifiably delayed until one month before the statute of limitations ran on the only overt act presented to the jury, and the prosecution forcefully exploited the delay in summation (faulty memories and Anderson's failure to produce additional witnesses from distant places), no "delicate judgment" is required. The violation of Due Process is clear.

IV.

There was no proof that petitioner conspired to file any false report with the SEC.

There was a total failure of proof that Anderson conspired to file any report with the SEC. It is conceded he had no knowledge of Rule 17a-5, and there was no testimony that he or anyone in his presence even mentioned the SEC or filing a report with the SEC.

It is fundamental that a conviction for conspiracy under 18 U.S.C. §371 cannot be sustained unless there is proof of an agreement to commit an offense against the United States. *Ingram* v. *United States,* 360 U.S. 672, 677-8 (1959), citing *Pereira* v. *United States,* 347 U.S. 1 (1954). An essential ingredient of the proof is knowledge of that federal nexus, without which knowledge the intent cannot exist. *Ingram* v. *United States, supra,* at pp. 678, 680, citing *Direct*

Sales Co. v. *United States,* 319 U.S. 703 (1943). Furthermore, to establish the intent, the evidence of knowledge must be clear, not equivocal. This is because charges of conspiracy are not to be made out by piling inference upon inference, fashioning a dragnet to draw in all substantive crimes. *Ingram* v. *United States, supra,* at p. 680; *Direct Sales Co.* v. *United States, supra,* at p. 711, citing *United States* v. *Falcone,* 311 U.S. 205 (1940).

CONCLUSION

For the foregoing reasons, petitioner requests this Court to grant the petition for a writ of certiorari.

Respectfully submitted,

JEROME J. LONDIN
10 East 40th Street
New York, N. Y. 10016
(212) 889-3600
Counsel for Petitioner

Dated, New York, N. Y.
May 6, 1976

APPENDICES

APPENDIX A

Opinion of United States Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 309, 313, 315—September Term, 1975.

(Argued October 22, 1975 Decided March 8, 1976.)

Docket Nos. 75-1246, 75-1280, 75-1303

UNITED STATES OF AMERICA,

Appellee,

v.

DONALD EUCKER, CARL W. ANDERSON and FERGUS M. SLOAN, JR.,

Defendants-Appellants.

Before:

MOORE, FEINBERG and VAN GRAAFEILAND,

Circuit Judges.

Appeal from judgments of conviction for securities law violations entered in the United States District Court for the Southern District of New York against appellant Anderson following a jury trial before Whitman Knapp, *District Judge,* and appellants Sloan and Eucker following pleas of guilty before Whitman Knapp, *District Judge.*

Affirmed as to appellants Anderson and Sloan and remanded as to appellant Eucker.

JEROME J. LONDIN, New York, N.Y. (Carro, Spanbock, Londin, Rodman & Fass, New

York, N.Y., Kenneth A. Lapatine, of Counsel), *for Appellant Anderson.*

MICHAEL ROSEN, New York, N.Y. (Saxe, Bacon & Bolan, P.C., New York, N.Y.; Roy M. Cohn, New York, N.Y., of Counsel), *for Appellant Sloan.*

STANLEY S. ARKIN, New York, N.Y. (Stanley S. Arkin, P.C., New York, N.Y., Mark S. Arisohn, of Counsel), *for Appellant Eucker.*

AUDREY STRAUSS, Assistant U.S. Attorney (Paul J. Curran, U.S. Attorney for the Southern District of New York, Robert J. Costello, Assistant U.S. Attorney, John C. Sabetta, Assistant U.S. Attorney, of Counsel), *for Appellee.*

VAN GRAAFEILAND, *Circuit Judge:*

In June 1970, Orvis Brothers, a Wall Street brokerage firm, closed its doors, leaving debts in excess of four million dollars. On September 10, 1974, appellants, officers of that company, were indicted in the Southern District of New York, charged in nine counts with conspiracy and substantive violations of the federal securities law. Only Anderson went to trial,[1] and he was convicted on the conspiracy count alone. Seven counts were dismissed by the trial judge, and the jury acquitted Anderson on the eighth. Sloan pleaded guilty to the conspiracy count, and Eucker pleaded guilty to a substantive count charging illegal hypothecation of customers' securities, reserving his right

1 In addition to appellants, two other defendants were indicted. One pleaded guilty to conspiracy and did not appeal. The other was tried with Anderson and was acquitted.

to appeal from the District Court's refusal to dismiss this count for failure to allege a crime.

Anderson appeals his conviction, asserting a number of substantive and procedural errors. Sloan appeals from District Judge Knapp's denial of his motion to withdraw his guilty plea, which motion was predicated upon the prosecutor's alleged failure to "go to bat" for Sloan with the sentencing judge as had been promised. Eucker appeals from the judgment based on his plea of guilty, in accordance with his reservation of the right to do so.

The Background for the Charges

Appellants were partners in Orvis Brothers, which had been in the securities business for many years. Sloan was the managing partner; Anderson was chairman of the Executive Committee, and Eucker, a member of the Executive Committee, was in charge of operations. In early 1969, Orvis was experiencing difficulty in maintaining the 20:1 capital ratio required by the rules of the New York Stock Exchange,[2] and its Executive Committee cast about for means of increasing its apparent capital. According to the Government's proof, some members cast too widely.[3]

The Orvis account most susceptible to manipulation was that of the Clinton Oil Company of Wichita, Kansas, whose president, Realto Clinton, was a close friend of appellant Sloan. Orvis was a broker for the Clinton Company in the sale of oil and gas exploration investment units, for which it received a six percent commission payable at the time the fourth and final installment of the purchase price

2 Liabilities are not permitted to exceed twenty times the amount of capital. N.Y.S.E. Rule 325.

3 There is substantial dispute as to many of the facts recited herein; but for purposes of this appeal, we must construe the proof most favorably to the Government. *McCarthy* v. *United States*, 473 F.2d 300, 302 (2d Cir. 1972).

of each unit was paid. Early in 1969, Orvis, at the suggestion of Sloan and with the knowledge of Anderson, began treating projected commissions as current capital. A fictitious customer account was created and $797,100 in projected but unearned commissions was entered in this account. To balance this unsecured debit, some stock of Realto Clinton in the possession of Orvis was wrongfully credited to the same account. Anderson learned of this transfer in September 1969.

A second fictitious addition to capital was created out of the sale of Clinton units by failing to record the forty percent sales commission payable to Orvis' employees. The decision not to deduct these commissions was known to Anderson and the other members of the Executive Committee.

In 1969, Clinton Oil Company sent Sloan 4,344 shares of Clinton stock with directions that it be sold to partners of Orvis, and Realto Clinton sent 5,000 shares for sale to a third party. These shares were posted in the Orvis' books as if they were a gift rather than a consignment, and Anderson learned of this posting in August 1969.

In the same month, it was discovered that the firm's own trading account had sustained an unexpected loss of $500,000, and Sloan called his friend Clinton to seek additional capital. Clinton agreed to, and did, forward $500,000. However, this was in payment of commissions for sale of Clinton oil and gas units and not as a loan to Sloan. Despite this fact, the money was placed in the firm's trading account, and no part of it was used to offset the $797,100 carried on the books as earned commissions. Although Anderson played no part in this transaction, he was aware of it.

In 1969, Orvis owned eighty thousand shares of Clinton Oil Company stock which could be evaluated at only sev-

enty percent of market value for capital ratio purposes under the rules of the New York Stock Exchange. In August, Sloan told his partners that this stock had been sold to the Clinton Oil Pension Fund and recorded the sale in the partnership books at one hundred percent of value. Although Clinton's general counsel informed Orvis by telegram that this "sale" had not occurred, and no payment was ever made, it remained on the books of Orvis as an obstensibly valid transaction.

At the time that this purported sale was taking place, general counsel for Clinton was in New York, attempting to ascertain the financial situation at Orvis. Anderson advised him that "there is no problem with the company" and that the capital ratio was "between 12 and 15 at that time, that the auditing firm was there at the moment and everything was all right." Clinton's counsel was not informed of the "sale" of Clinton stock and did not learn about it until his return to Kansas, at which time he promptly disaffirmed it. On a second visit made in December 1969, Clinton's counsel was again assured by Anderson and Sloan that there was no cause for concern over the financial condition of Orvis.

Machinations at Orvis were not confined to the Clinton account. In the fall of 1968, Anderson attempted to negotiate the sale of nineteen thousand shares of unregistered International Controls Company stock from customers of Orvis to a mutual fund called the Fund of Letters. After Orvis had purchased the stock from its customers for almost $500,000, the Fund of Letters refused to accept it because International Controls Company would not register the stock. Despite this refusal, the cost of the stock was not charged against capital but was carried for fourteen months on the books of Orvis as a customer cash account with a settlement date of five business days.

Also, during 1968 and 1969, Orvis began to use fully paid for customers' securities as collateral for partnership bank loans. When Haskins & Sells, the company auditor, was securing information required for Orvis' October 1969 Form X-17A-5 report of financial condition to the New York Stock Exchange and the Securities and Exchange Commission (SEC), approximately six million dollars in customers' securities were so hypothecated. Haskins & Sells was advised, however, that this was being corrected, and so stated in its report. The advice and the report were both erroneous. By May 1970, the hypothecation of fully paid for customers' securities exceeded six and one-half million dollars. The Government introduced evidence that Anderson, by that time, was fully aware of what was being done but urged that this knowledge be kept from the other members of the Executive Committee.

Information concerning all of the manipulations outlined herein was kept from Haskins & Sells, although the X-17A-5 report was reviewed in detail at a meeting with representatives of the auditor which was attended by appellants. As a result, the report which was filed indicated that Orvis was not in any financial difficulty, and its capital ratio was satisfactory.

The Statutes Involved[4]

15 U.S.C. § 78q(a) provides in part that every registered broker shall keep "such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the [Securities and Exchange] Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors."

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4 The securities statutes referred to have since been renumbered. *See* Pub. L. No. 94-29.

15 U.S.C. § 78ff(a) provides in substance that anyone "who willfully violates [§ 78q(a)] or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required," or "who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder . . . which statement was false or misleading with respect to any material fact, shall upon conviction be fined . . ., or imprisoned . . ., or both." This section further provides, however, that no person shall be subject to imprisonment thereunder "for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation."

15 U.S.C. § 78h(c) makes it unlawful for a broker, in contravention of the rules and regulations of the SEC, to hypothecate any customer's securities "under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer, (2) that will permit such securities to be commingled with the securities of any person other than a bona fide customer, or (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities."

18 U.S.C. § 371 prohibits conspiracies to commit any offense against the United States. It provides for a fine, imprisonment or both, except where the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, in which event the punishment for the conspiracy cannot exceed the maximum punishment provided for such misdemeanor.

The SEC has elaborated on the provisions of the Securities Exchange Act with its own rules and regulations.

Rules 17a-3 and 4, 17 C.F.R. §§ 240.17a-3, 4, detail the business records required to be kept and preserved by securities dealers. Rule 17a-5, 17 C.F.R. § 240.17a-5, requires that brokers file Form X-17A-5 financial reports and specifies the contents of these reports. Rule 8c-1, 17 C.F.R. § 240.8c-1, prohibits the hypothecation of securities, in language similar to that of 15 U.S.C. § 78h(c).

Anderson's Appeal

Anderson was convicted of conspiracy to violate §§ 78ff (a) and 78q(a) and Rules 17-a-3, 4 and 5. As reduced by the trial judge, the charge of wrongdoing submitted to the jury was that Anderson conspired to file an X-17A-5 report with the SEC which was false, in that statements of the accounts of Orvis and its customers were inflated and the improper hypothecation of customers' securities was wrongfully stated to have been corrected.

Although appellant argues that he was not a member of any conspiracy, but at most a silent onlooker, this argument is not persuasive. Where the goal of a conspiracy can be reached only through deception and concealment, silence which is designed to conceal may indicate an intention to conspire. *United States* v. *Colasurdo,* 453 F.2d 585, 592-93 (2d Cir. 1971), *cert. denied,* 406 U.S. 917 (1972). The trial court instructed the jury that to be an act in furtherance of a conspiracy, "silence must be a planned act" and that if intended to facilitate the conspiracy, it can be an overt act in pursuance thereof. This was a correct statement of the law. *United States* v. *Freeman,* 498 F.2d 569, 575 n. 10 (2d Cir. 1974); *Forman* v. *United States,* 259 F.2d 128 (9th Cir. 1958), *modified,* 261 F.2d 181 (1959) (per curiam), *aff'd* 361 U.S. 416 (1960).

While the concealment which occurred in this case may have been intended in part to deceive potential sources of capital, it was also clearly designed to delude the New

York Stock Exchange and the SEC. Unless Orvis could maintain its capital ratio at 20:1 or better, it was not going to continue long in operation. The *sine qua non* of the fraud on these agencies was the filing of the false Form X-17A-5, and the jury could well find that the concealment of the true facts required for this report was as much a part of its preparation as the writing on the document. It could also decide that Anderson, who stood silently by as the false contents of the X-17A-5 report were reviewed with the company auditor in preparation for filing, was not an innocent bystander.

Moreover, the Government established that Anderson did more than simply remain silent. At a meeting of the Executive Committee in April 1969, after he was told of some of the improper bookkeeping practices, Anderson instructed the partner in charge of financial operations to make sure the firm stayed in business. Anderson also deliberately misled Clinton Oil Company's general counsel concerning the financial position of Orvis. These, the jury could find, were acts of a vocally active participant in the alleged conspiracy. In short we find that there was substantial evidence in support of the jury's verdict.

We find no error in the District Court's evidentiary rulings. Although the Government did not contend that Anderson was aware of the allegedly improper hypothecation of customers' securities at any time before the X-17A-5 report was filed, proof of such hypothecation was, nonetheless, properly admitted. If the filing of false information concerning hypothecation was within the scope of the conspiracy, Anderson, as one of the conspirators, cannot avoid the consequences by claiming lack of knowledge. *United States* v. *Manton,* 107 F.2d 834, 848 (2d Cir. 1939), *cert. denied,* 309 U.S. 664 (1940). The Government contended that the conspirators misrepresented to the SEC that the situation involving hypothecation had been cor-

rected, and it was necessary for the Government to establish that the correction had, indeed, not taken place. Whether, as appellant now asserts, the Government failed to prove that the hypothecation was unlawful is beside the point; the SEC was entitled to truthful information. The wrongful act charged was the filing of the false report, not the hypothecation.

Similar reasoning supports the admissibility of evidence concerning the Fund of Letters transaction. The alleged conspiratorial act submitted to the jury was the false handling of the Fund of Letters account as a secured cash account in the X-17A-5 report, and proof of the underlying facts was necessary to establish the falsity. Anderson's asserted lack of knowledge concerning bookkeeping details did not require exclusion of this evidence.

Anderson contends that he was denied his Fifth Amendment right to due process because he was not indicted until just prior to the running of the five year statute of limitations. Appellant did not raise this issue until after his conviction and waived his right to do so. *United States* v. *Beigel,* 370 F.2d 751, 757 (2d Cir.), *cert. denied,* 387 U.S. 930 (1967). A defendant cannot wait to see whether the verdict is to his liking before arguing that he was prejudiced by delay.

In any event, we would be disinclined to reduce the period of limitations prescribed by Congress in the absence of some proof that the Government utilized the delay as "an intentional device to gain tactical advantage over the accused" and that defendant was prejudiced thereby. *United States* v. *Marion,* 404 U.S. 307, 324 (1971). Appellant failed to show any contrived procrastination by the Government and could point to no prejudice established beyond mere conjecture. We see no error here.

There is likewise no merit to Anderson's contention that he was further deprived of his Fifth Amendment rights by

the Government's failure to call before the grand jury a witness whose testimony would have tended to weaken the Government's case. In advancing this argument, appellant pays little heed to the fact that the testimony of the witness, who was the attorney for another defendant, would have been, to a large extent, privileged. Moreover, he ignores the well established rule that the Government need not call all available witnesses before the grand jury. *United States* v. *Koska,* 443 F.2d 1167, 1169 (2d Cir.) (per curiam), *cert. denied,* 404 U.S. 852 (1971).

Anderson's final claim of error relates to his sentence of imprisonment. As pointed out above, 18 U.S.C. § 371, the conspiracy statute, provides that where the object of a conspiracy is a misdemeanor, the punishment for the conspiracy cannot exceed the maximum punishment for the misdemeanor. 15 U.S.C. § 78ff(a) provides that no person shall be subject to imprisonment thereunder for the violation of any rule or regulation of which he had no knowledge. This means that under 18 U.S.C. § 1 the violation of an unknown rule or regulation of the S.E.C. can be no more than a misdemeanor,[5] and the violator can receive no more than a fine.

Anderson contends that he was convicted under § 78ff(a) of a violation of Rules 17a-3, 4 and 5. The Government, on the other hand, argues that he was convicted for a violation of the statute itself. The Government is correct. The charge of wrongdoing submitted to the jury was not the failure to keep and preserve records and file reports as required by the rules; it was the making of false and misleading statements in a report, which conduct was specifically proscribed by § 78ff(a). Anderson is therefore not

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5 Under 18 U.S.C. § 1, offenses punishable by death or imprisonment exceeding one year are felonies; all others are misdemeanors.

entitled to rely on the "no knowledge" portion of that statute. *United States* v. *Colasurdo, supra,* 453 F.2d at 594.

Sloan's Appeal

The Assistant United States Attorney who represented the Government on the trial promised Sloan that if he pleaded guilty and cooperated in the preparation and presentation of the case against Anderson, the Government would "go to bat" for him. Thereafter, Sloan pleaded guilty. However, his cooperation consisted of presenting the prosecution with a version of the facts in which he attempted to completely exculpate himself from any wrongdoing. Under these circumstances the Government was unwilling to vouch for his credibility and did not call him as a witness. The prosecutor also did not "go to bat" for him, because he did not consider Sloan's willingness to testify falsely to be cooperation.

The District Court found that this decision was made in good faith and refused to permit Sloan to withdraw his plea. The District Court's determination was discretionary, *United States* v. *Giuliano,* 348 F.2d 217, 221 (2d Cir.), *cert. denied,* 382 U.S. 939 (1965), and we see no reason to disturb it. Appellant cannot claim the benefit of an agreement where he himself is in default. *United States* v. *Nathan,* 476 F.2d 456, 459 (2d Cir.), *cert. denied,* 414 U.S. 823 (1973).

Eucker's Appeal

Count Nine of the indictment, to which Eucker pleaded guilty, charged that he:

> unlawfully, wilfully and knowingly, did, directly and indirectly, hypothecate and arrange for and permit the continued hypothecation of fully paid for securities carried for the account of customers of Orvis under

> circumstances that permitted such securities to be hypothecated and subjected to liens and claims of pledges in amounts up to $7,000,000.00. (Title 15, United States Code, Sections 78h and 78ff and 17 C.F.R. Section 240.8c-1; Title 18, United States Code, Section 2.)

Eucker argues that this count fails to allege an essential element of the crime charged, to wit, that the total amount of securities hypothecated was in excess of the aggregate customer indebtedness to Orvis with respect to such securities. In making this argument, Eucker assumes that he is charged with violating subsection 3 of 15 U.S.C. § 78h(c).

The Government says, on the other hand, that it never intended to proceed under subsection 3 and that it was really proceeding under subsection 1, which prohibits the commingling of a customer's securities without his written consent with the securities of any other customer.[6] The Government also contends that the hypothecation of fully paid for customers' securities constitutes a fraud in violation of 15 U.S.C. §§ 78j(b), 78o(c) and 77q(a).

Because appellant Eucker admitted at the time of his plea that he caused or permitted fully paid customers' securities to be hypothecated as charged in the indictment, we could on this appeal go directly to the merits of the Government's contention. The statutory reference in the indictment obviously includes all three subsections of § 78h(c). With regard to the other statutes upon which the Government now seeks to rely, if an indictment properly charges an offense, it is sufficient, even though an inapposite statute

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6 For some unknown reason, the Government makes no mention of subsection 2 of 15 U.S.C. 78h(c) which prohibits commingling regardless of consent with the securities of anyone other than a bona fide customer, *i.e.*, presumably with those of the broker himself.

is referred to therein. 1 Wright, Federal Practice and Procedure § 124 *et seq.* (1969); *United States* v. *Calabro*, 467 F.2d 973, 981 (2d Cir. 1972), *cert. denied*, 410 U.S. 926 (1973). Clearly the Government is not required to rely upon that statutory provision which the defendant chooses to select.

However, a defendant's plea should be made with an understanding of the nature of the charge against him, *Irizarry* v. *United States*, 508 F.2d 960, 963-66 (2d Cir. 1974), and there is a possibility that this did not occur in this case. Pursuant to the authority given us by 28 U.S.C. § 2106, we are therefore remanding the case of the appellant Eucker to the District Court so that appellant may apply to that court for leave to withdraw his plea of guilty on the ground that it was not knowingly made as required by Fed. R. Crim. P. 11. If such an application is made, the district court shall grant the motion upon appropriate conditions if it finds, bearing in mind the Government's contentions, that appellant's plea was made without knowledge of the possible applicability of 15 U.S.C. §§ 78h(c)(1) and (2), 78j(b), 78o(c) and 77q(a). If this application is not made within thirty days from the date of remand, however, we will conclude that appellant's plea was, in fact, made with an understanding of the possible applicability of the above sections. In the event that application is not timely made, or if the District Court denies appellant's motion for leave to replead, the matter shall be returned to this Court for a decision on the merits. If the motion is granted, this appeal will be dismissed as moot.

Disposition of Appeal

The judgments of conviction of appellants Anderson and Sloan are affirmed. The case of appellant Eucker is remanded to the District Court for further proceedings in accordance with this opinion.

MOORE, *Circuit Judge* (Concurring and Dissenting):

I concur in the affirmance of Anderson's and Sloan's convictions, but dissent from the majority's decision to remand as to Eucker.

A defendant should not plead guilty to charges of which he is ignorant or about which he is confused. However, the facts in this case belie any argument that Eucker was either ignorant or confused at the time of his plea. Eucker was a member of the Executive Committee of Orvis Brothers, the partner in charge of operations, and a man obviously sophisticated in his knowledge both of the securities industry and its extensive regulation by the federal government. Count Nine of the indictment expressly referred to 15 U.S.C. § 78h,[1] all three subsections and its various subparts of § 78h were obviously included thereby.

Eucker was represented by counsel throughout the litigation at bar. He pleaded guilty on the express understanding that he would appeal that very plea.[2] He made no claim of ignorance or confusion before the district court[3]

1 Reference in the majority opinion, at p. 12, to §§ 78j(b), 780(c), and 77q(a) is inapposite in view of the facts that Eucker was indicted under and pleaded guilty to §78h; was convicted under § 78h; and has predicated his appeal on the sufficiency of the indictment's recitation of § 78h.

2 Appellant Eucker's appendix at 50. All references to "appellant" herein are to Eucker.

3 In urging that appellant be permitted an immediate appeal from his plea of guilty, Eucker's counsel argued that the statute was vague, an argument which was given weight by the district court. [Transcript of proceedings, March 14, 1975, Appellant's appendix at 29: ". . . I agree with your Honor that the statute is not a model of clarity . . . I

or on appeal to this Court.[4] He has alleged only that the Government failed to draft an indictment correct in all its technical form and detail, thereby rendering that indictment "fatally defective".[5] Eucker does not claim that he failed to understand the charges against him;[6] he merely

believe your Honor understands my intention with respect to the plea that is to be offered today which is to have my client, Mr. Eucker, plead to the indictment as drafted, and of course denying that the aggregate net indebtedness of all the customers exceeded the amount of the hypothecation, and then taking that up upstairs for a hopeful clarification of what the statute means."] However, it should be noted that appellant has *not* raised that issue on appeal; on the contrary, he fails even to cite it as a basis for the district judge's decision respecting appealability of the plea—a curious omission. [Appellant's brief at 6: "Eucker moved to dismiss Count 9 upon the ground that the count failed to allege an essential element of the crime charged, to wit, that the total amount of securities hypothecated was in excess of the aggregate indebtedness to Orvis of all customers on all of their securities carried for their account by Orvis. The motion to dismiss Count 9 was denied."] This, in addition to Eucker's own statements before the district court, *see* n. 5, *infra*, give to his counsel's statements about vagueness the distinct appearance of tactical maneuver as opposed to the legitimate expression of any true "confusion" felt by Eucker respecting the meaning of either § 78h or the charges brought hereunder.

4 *See* "Questions Presented", Appellant's brief at 1-2.

5 Appellant's brief at 1.

6 The following excerpt from the proceedings before the district court is instructive:

"BY THE CLERK:

Q. Are you the Donald Eucker in the case presently before this Court?

A. Yes, I am.

Q. Do you waive formal reading of the indictment in this matter?

A. Yes, I do.

Q. *Do you fully understand the charges in Count 9 of this indictment?*

A. *Yes, I do.*

Q. How do you wish to plead to that count?

A. I wish to plead guilty."

Transcript of proceedings, March 14, 1975, Appellant's appendix at 37-38 (emphasis supplied).

posits that the law should not apply to him because the *text* of the indictment preceding the citation to § 78h was largely taken from a subsection in the statute which could not apply to his particular acts.

The majority properly concludes that the Government is not compelled to abide by a defendant's selective interpretation of his indictment. However, by remanding the case at this point, the majority undermines its own holding. The remand prolongs this litigation unnecessarily, and its effect is to clothe Eucker with an innocence which the facts plainly refute. Eucker should not be given the opportunity —at this late stage in the proceedings—to plead a state of ignorance or helpless confusion which is disingenuous and completely contrary to the record.

I would reach the merits of his appeal at this time and would affirm his conviction on the grounds that the indictment adequately set forth the charges to which he pleaded guilty.

APPENDIX B

Opinion of United States District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

74 Cr. 859

UNITED STATES OF AMERICA,

Plaintiff,

-against-

FERGUS M. SLOAN, JR., et al.,

Defendants.

MEMORANDUM AND ORDER

WHITMAN KNAPP, District Judge.

Defendant Carl W. Anderson moves to set aside this Court's sentence of imprisonment imposed on June 16, 1975. He argues that no imprisonment may be imposed under the circumstances of this case because of the peculiar interplay of the conspiracy statute, 18 U.S.C. § 371, and the sentencing provision of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a). We disagree.

The defendant was convicted after a month-long jury trial of conspiring to violate the federal securities laws, particularly 15 U.S.C. § 78q(a) and three Securities and Exchange Commission regulations promulgated thereunder, 17 C.F.R. §§ 240.17a-3, 4, and 5. The cited statute provides, in pertinent part, that every broker or dealer

> "shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors."

The three SEC regulations here involved —promulgated pursuant to that statute— list the specific records and documents that must be accurately made, preserved and filed.

The charges in this case arose out of the financial collapse of Orvis Brothers & Co., a member of the New York Stock Exchange. The motivation for the conspiracy, according to the government's proof at trial, was a desire among certain partners at Orvis, including Anderson, to hide the fact of the firm's deteriorating financial condition from the Stock Exchange and the appropriate regulatory agencies. The method for achieving this purpose was the making and filing of inaccurate records and documents, all in contravention of the securities laws.

The main issues litigated at Anderson's trial were twofold: first, was there a conspiracy among certain of the partners at Orvis to maintain false records and file false financial statements with the SEC; and secondly, was the defendant Anderson a knowing and willful participant in such an unlawful enterprise. The jury resolved both of these issues against the defendant.

In arguing against the imposition of a jail sentence, Anderson relies, as noted above, on the interplay between the conspiracy section under which he was convicted, 18 U.S.C. § 371, and the penal provision of the Securities Act, 15 U.S.C. § 78ff(a).

The conspiracy provision, after defining the crime and prescribing the penalty, contains a proviso which states:

> "If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor."

Anderson thus maintains that it is necessary to determine whether the conspiracy of which he was convicted had as its object the commission of an offense which is solely a misdemeanor. This inquiry requires reference to 15 U.S.C. § 78ff(a), the penal provision of the 1934 Securities Act. This statute reads as follows,

> "(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; *but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.*" (emphasis added)

Under 18 U.S.C. § 1, the crime defined is a felony.[1] However, the quoted statute's final clause (emphasized above) carves out a special exception which prohibits imprisonment of a person convicted under 15 U.S.C. § 78ff(a)

1. 18 U.S.C. § 1 classifies offenses as follows: "Notwithstanding any Act of Congress to the contrary:
(1) Any offense punishable by death or imprisonment for a term exceeding one year is a felony.
(2) Any other offense is a misdemeanor.
(3) Any misdemeanor, the penalty for which does not exceed imprisonment for a period of six months or a fine of not more than $500, or both, is a petty offense."

for a violation of a *rule* or *regulation* of which such person was wholly ignorant.[2]

Relying exclusively on this so-called "no knowledge" proviso, Anderson claims that because he was wholly ignorant of the specific requirements set forth in SEC regulations 17 C.F.R. §§ 240.17a–3, 4, and 5, he would only be subject to punishment under 15 U.S.C. § 78ff(a) by a fine not to exceed $10,000. Since any offense punishable by a fine only is classified as a misdemeanor,[3] Anderson completes his syllogism by concluding that he can only be fined up to $10,000 on the conspiracy conviction.

The weakness in this argument is that it is based on an inaccurate interpretation of the purposes of the "no knowledge" proviso in 15 U.S.C. § 78ff(a). This clause is rather unique in that it permits a defendant prior to sentencing to rebut the presumption that he had knowledge of the rule or regulation of which he had been convicted of violating. It was included in the 1934 Act as a compromise measure to allay certain fears in Congress that, by enacting a vast new securities statute giving broad rule-making authority to the SEC, and by making violations of such rules criminal, the legislators were subjecting totally "innocent" people—persons who might act without knowledge that their conduct was now prohibited by a rule—to possible incarceration. The compromise impliedly recognized that under such circumstances, strict adherence to the presumption of knowledge of the law would be unwarranted. See, Herlands, *Criminal Aspects of the Securities Exchange Act of 1934*, 21 Virginia L.Rev. 139, 190–193 (1934); *United States* v. *Lilley* (S.D.Texas 1968) 291 F.Supp. 989; *United States* v. *Guterma* (S.D. N.Y.1960) 189 F.Supp. 265.

[1] It is equally clear, however, that Congress did intend to maintain the usual presumption of knowledge with respect to the standards prescribed in the securities acts themselves. The "no knowledge" proviso is explicitly limited to lack of knowledge of a "rule or regulation". Congress did not intend that the protection of the "no knowledge" clause would extend to persons who were charged with knowing their conduct to be in violation of law, but did not happen to know that it was also in violation of a particular SEC rule or regulation. See, *United States* v. *Lilley*, *supra*, 291 F.Supp. 989, 993.

[2, 3] It is this latter situation that we here encounter. Anderson is not a totally innocent person who committed a non-wilful technical violation of an SEC rule or regulation. Anderson was accused and convicted of conspiring to violate 15 U.S.C. § 78q(a) which makes it a crime to make and file false and inaccurate records and documents. In order to convict him of this offense, the jury was required to find that he had formulated the deliberate intent to further an unlawful objective. Thus, the court instructed the jury that Anderson could not be deemed a conspirator unless he had (TR 3031–2):

> "Knowledge of the basic unlawful object of the conspiracy, in this case, deceptive record keeping and deceptive filing with the S.E.C. to conceal financial weakness; and that it was his deliberate intent to further that unlawful objective."

Under these circumstances, it seems irrelevant whether Anderson knew of the

2. As is apparent from a careful reading of both 18 U.S.C. § 371 and 15 U.S.C. § 78ff(a), the "no knowledge" proviso may not even apply to sentences under the conspiracy statute. A violation of 15 U.S.C. § 78ff(a), for example, is not a "misdemeanor only" since the crime is punishable by more than one year imprisonment. Secondly, the "no knowledge" proviso only modifies the felony penalty if the defendant is "subject to imprisonment *under this section* for the violation of any rule or regulation" (emphasis added). In the case at bar, Anderson is being sentenced under 18 U.S.C. § 371 and not 15 U.S.C. § 78ff(a).

3. See, 18 U.S.C. § 1, *supra*, n. 1.

specific rules which were violated. The "no knowledge" proviso was not intended to permit one who knowingly conspires to violate the general standard of conduct set forth in 15 U.S.C. § 78q(a) to claim protection on the ground that he did not have knowledge of some specific rule or requirement promulgated thereunder. Such an interpretation would go well beyond what Congress intended when it inserted the "no knowledge" proviso and would be wholly inconsistent with the substantive law of conspiracy, which makes one co-conspirator liable for acts committed by other co-conspirators done in furtherance of the conspiracy, *Pinkerton* v. *United States* (1946) 328 U.S. 640, 66 S.Ct. 1180, 90 L.Ed. 1489.

As we have now made clear, we deem it immaterial whether or not Anderson was aware of the existence of the particular rule which required the filing of any particular record or document found to have been false. We may observe, however, that if this conclusion should be found erroneous, we would find no persuasive reason for disbelieving Anderson's testimony that he had been unaware of the specific requirements of 17 C.F.R. § 240.17a–3, 4, and 5. Indeed, the verdict of acquittal on the substantive count may have been based on the jury's acceptance—at least to the extent of creating a reasonable doubt—of Anderson's testimony in this general regard. The charge on this count required a specific finding that the particular false filing had been within Anderson's "reasonable contemplation."[4]

Accordingly, Anderson's motion to set aside the sentence of imprisonment is denied. Final judgment will enter within five days. The execution of sentence will be stayed pending appeal.

So ordered.

4. The charge given on the substantive count was more favorable to Anderson than the charge specifically approved in *Pinkerton* v. *United States* (1946) 328 U.S. 640, 66 S.Ct. 1180, 90 L.Ed. 1489. It comports to, what in our view, is the practice of this Circuit. Cf. *Pinkerton*, 328 U.S. at 647–648, 66 S.Ct. 1180.

APPENDIX C

Constitution

AMENDMENT V—CAPITAL CRIMES; DOUBLE JEOPARDY; SELF-INCRIMINATION; DUE PROCESS; JUST COMPENSATION FOR PROPERTY

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

AMENDMENT VI—JURY TRIAL FOR CRIMES, AND PROCEDURAL RIGHTS

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

STATUTES AND RULES

15 U.S.C. § 78h. Restrictions on borrowing by members, brokers, and dealers

It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly—

* * *

(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer, (2) that will permit such securities to be commingled with the securities of any person other than a bona fide customer, or (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect of such securities. (Prior to amendment by P.L. 94-29, effective June 4, 1975 which redesignated subsection (c) as subsection (b).)

15 U.S.C. § 78q. Accounts and records, reports, examinations of exchanges, members and others

(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 78o of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

(Prior to amendment by P.L. 94-29, effective June 4, 1975.)

15 U.S.C. **§ 78ff. Penalties**

(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

(Prior to amendment by P.L. 94-29, effective June 4, 1975.)

Rule 8c-1(a), 17 C.F.R. §240.8c-1(a)

Rule 8c-1. Hypothecation of Customers' Securities.

(a) GENERAL PROVISIONS.— No member of a national securities exchange, and no broker or dealer who transacts a business in securities through the medium of any such member shall, directly or indirectly, hypothecate or arrange for or permit the continued hypothecation of any securities carried for the account of any customer under circumstances—

(1) that will permit the commingling of securities carried for the account of any such customer with securities carried for the account of any other customer, without first obtaining the written consent of each such customer to such hypothecation;

(2) that will permit such securities to be commingled with securities carried for the account of any person other than a bona fide customer of such member, broker or dealer under a lien for a loan made to such member, broker or dealer; or

(3) that will permit securities carried for the account of customers to be hypothecated, or subjected to any lien or liens or claim or claims of the pledgee or pledgees, for a sum which exceeds the aggregate indebtedness of all customers in respect of securities carried for their accounts; except that this clause shall not be deemed to be violated by reason of an excess arising on any day through the reduction of the aggregate indebtedness of customers on such day, provided that funds or securities in an amount sufficient to eliminate such excess are paid or placed in transfer to pledgees for the purpose of reducing the sum of the liens or claims to which securities carried for the account of customers are subjected as promptly as practicable after such reduction occurs, but before the lapse of one-half hour after the commencement of banking hours on the next banking day at the place where the largest principal amount of loans of such member, broker or dealer are payable and, in any event, before such member, broker or dealer on such day has obtained or increased any bank loan collateralized by securities carried for the account of customers.

Rule 17a-5, 17 C.F.R. §240.17a-5

Rule 17a-5. Reports To Be Made By Certain Exchange Members, Brokers and Dealers.

(a)(1) FILING REPORTS.—This rule shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer registered pursuant to Section 15 of the Act.

Every member, broker or dealer subject to this rule shall file reports of financial condition containing the information required by Form X-17A-5, as follows: (A) a report shall be filed as of a date within each calendar year, except that (i) the first such report of a member, broker or dealer (other than one succeeding to and continuing the business of another member, broker or dealer) shall be as of a date not less than one nor more than five months after the date on which such member, broker or dealer becomes subject to this rule (in the case of a registered broker or dealer this shall be the date the registration becomes effective) and (ii) a member, broker or dealer succeeding to and continuing the business of another member, broker or dealer need not file a report as of a date in the calendar year in which the succession occurs if the predecessor member, broker or dealer has filed a Form X-17A-5 report in compliance with this rule as of a date in such calendar year; (B) such reports shall be filed not more than sixty (60) days after the date of the report of financial condition; and (C) reports for any two consecutive years shall not be as of dates within four months of each other; and, (D) the member, broker or dealer shall on the date on which a preliminary audit examination commences, if the preliminary audit procedures performed requires a report on Part III of Form X-17A-5, notify in writing the Regional Office of the Commission for the region in which the member, broker or dealer has its principal place of business that such preliminary audit examination has commenced and shall file as required by subparagraph (a) (2), not later than 45 days thereafter, a duplicate original of Part III of Form X-17A-5, signed by an officer, partner or principal, with such Regional Office which shall be deemed confidential.

(a)(2) The reports provided for in this rule shall be filed in duplicate original with the Regional Office of the Commission for the region in which the member, broker or dealer has his or its principal place of business and except as provided for in subparagraph (b)(3) shall be available for examination at the principal office of the member, broker or dealer.

(b) NATURE AND FORM OF REPORTS.— Each report of financial condition filed pursuant to paragraph (a) hereof shall be prepared and filed in accordance with the following requirements:

(1) The report of a member, broker or dealer shall be certified by a certified public accountant or a public accountant who shall be in fact independent; *provided, however,* that such report need not be certified if, since the date of the previous financial statement or report filed pursuant to Rule 17 CFR 240.15b1-2 or 17 CFR 240.17a-5 (A) said member has not transacted a business in securities directly with or for others than members of a national securities exchange; has not carried any margin account, credit balance or security for any person other than a general partner; and has not been required to file a certified financial statement with any national securities exchange; or (B) his or its securities business has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or (C) his or its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed of trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance, or security for any securities customer. A member, broker or dealer who files a report which is not certified shall include in the oath or affirmation required by paragraph (b) (2) of this rule a statement of the facts and circumstances relied upon as a basis for exemption from the certification requirements.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, (A) the financial statement and supporting schedules are true and correct and (B) neither the member, broker, or dealer, nor any partner, officer, or director, as the case may be, has any proprietary interest in any account classified solely as that of a customer. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall

be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer.

(3) If the schedules furnished pursuant to the requirements of items (a), (b) and (c) of Part II are bound separately from the balance of the report, they shall be deemed confidential, except that they shall be available for official use by any official or employee of the United States or any state, by national securities exchanges and national securities associations of which the person filing such report is a member, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this paragraph shall be deemed to be in derogation of the rules of any national securities association or national securities exchange which give to customers of a member, broker, or dealer the right, upon request to such member, broker, or dealer, to obtain information relative to his financial condition.

(4) The member, broker or dealer shall file with the report a supplemental report and a certification of the independent public accountant on the status of the membership of the member, broker or dealer in the Securities Investor Protection Corporation (SIPC). The report shall cover the SIPC annual general assessment reconciliation or exclusion from membership forms, not previously reported on under this subparagraph, which were required to be filed prior to the date of the report required by paragraph (a) of this rule. The supplemental report, which shall be submitted in triplicate original, be bound separately, be dated and be signed manually, shall include the following:

A. A schedule of assessment payments shall also show any overpayments applied and overpayments carried forward including: payment dates, amounts (state separately amounts of initial and general assessment payments) and name of SIPC collection agent to whom mailed, or

B. If exclusion from membership was claimed for such year(s), a statement that the respondent qualified for exclusion from membership under Section 3(a)(2) of the Securities Investor Protection Act of 1970 and the date and name of the SIPC collection agent with whom a Certification of Exclusion from Membership (Form SIPC-3) was filed, and

C. An accountant's certificate which shall state that in his opinion either the assessments were determined fairly in accordance with applicable instructions and forms, or that a claim for exclusion from membership was consistent with income reported, however, if his examination of the financial statements did not provide the basis for issuing such a certification, the accountant shall state the extent of his review. If exceptions are noted, he shall state any corrective action taken or proposed. The accountant's review on which his certificate is based shall include as a minimum the following procedures:

(i) Comparison of listed assessment payments with respective cash disbursements record entries,

(ii) Comparison of amounts reported for the calendar year(s) on Form X-17A-10 (or the equivalent form of a national securities exchange or registered securities association) with amounts reported in the Annual General Assessment Reconciliation (Form SIPC-7),

(iii) Comparison of adjustments reported in Form SIPC-7 with supporting schedules and working papers,

(iv) Proof of arithmetical accuracy of the calculations reflected in Form SIPC-7 and in the schedules and working papers supporting adjustments,

(v) Comparison of the amount of any overpayment applied with the Form SIPC-7 on which it was computed, or

(vi) If exclusion from membership is claimed, the accountant shall review Form X-17A-10 (or the equivalent form) to ascertain that the Certification of Exclusion from Membership (Form SIPC-3) was consistent with the income reported.

(c) USE OF CERTAIN STATEMENTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, STATE COMMISSIONS AND NATIONAL SECURITIES EXCHANGES.

(1) Any member, broker, or dealer who is subject to the provisions of paragraph (a) hereof may file in lieu of the report required by that paragraph a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member, or with any agency of any State as a condition of doing business in securities therein: *Provided*, That (A) the copy so included reflects his financial condition as of a date not more than sixty (60) days prior to the filing thereof with the Commission; and (B) the report, as filed with this Commission, meets the requirements of this rule and form X-17A-5 and contains the information called for by that form.

(2) At the request of any member, broker, or dealer who is (A) an investment company registered under the Investment Company Act of 1940, or (B) a sponsor or depositor of such a registered investment company who effects transactions in securities only with, or on behalf of, such registered investment company, the Commission will accept any statement of his financial condition filed pursuant to sections 13 or 15 (d) of the Securities Exchange Act of 1934 or section 30 of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder as a filing pursuant to this rule. Such a filing shall be deemed to satisfy the requirements of this rule for any calendar year in which such a financial statement is filed: *Provided*, That the statement so filed meets the requirements of the other rules under which it is filed with respect to time of filing and content.

(d) EXTENSION OF TIME FOR FILING REPORTS.—In the event any member, broker, or dealer finds that he cannot file his report for any year within the time specified in paragraphs (a) or (c) hereof without undue hardship, he may file with the Commission an application for an extension of time to a specified date which shall not be more than 90 days after the date as of which his financial condition is reported. The application shall state the reasons for the requested extension and shall contain an agreement to file the report on or before the specified date. The application shall be deemed granted unless the Commission, within ten days after receipt thereof, enters an order denying the application.

(e) EXEMPTIONS.—Any "bank," as defined in section 3 (a) (6) of the Act, shall be exempt from the provisions of this rule.

(f) QUALIFICATIONS AND REPLACEMENT OF ACCOUNTANTS.

(1) QUALIFICATIONS OF ACCOUNTANTS.—The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of his place of residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(2) REPLACEMENT OF ACCOUNTANT.—A member, broker or dealer shall file a notice with the regional office of the Commission for the region in which its principal place of business is located not more than 15 days after:

(A) The member, broker or dealer has notified the accountant who certified the report of financial condition in the most recent report filed under this rule that his services will not be utilized in future engagements; or

(B) The member, broker or dealer has notified an accountant who was engaged to certify a report of financial condition under this rule that the engagement has been terminated; or

(C) An accountant has notified the member, broker or dealer that he would not continue under an engagement to certify a report of financial condition; or

(D) A new accountant has been engaged to certify a report of financial condition without any notice of termination having been given to or by the previously engaged accountant.

Such notice shall state (i) the date of notification of the termination of the engagement or engagement of the new accountant as applicable and (ii) the details of any problems existing during the 24 months (or the period of the engagement if less) preceding such termination or new engagement relating to any matter of accounting principles or practices, financial statement disclosure, auditing procedure, or compliance with applicable rules of the Commission, which problems, if not resolved to the satisfaction of the displaced accountant, would have caused him to refer to them in his opinion. The member, broker or dealer shall also request the displaced accountant to furnish the member, broker or dealer with a letter addressed to the Commission stating whether he agrees with the statements contained in the notice of the member, broker or dealer and, if not, stating the respects in which he does not agree. The member, broker or dealer shall file three copies of the notice and the accountant's letter, one copy of which shall be manually signed by the sole proprietor, or a general partner or a duly authorized corporate officer, as appropriate, and by the accountant, respectively.

(g) ACCOUNTANT'S CERTIFICATE.

(1) TECHNICAL REQUIREMENTS.—The accountant's certificate shall be dated, shall be

signed manually, and shall identify without detailed enumeration the items of the report covered by the certificate.

(2) REPRESENTATIONS AS TO AUDIT.—The accountant's certificate (A) shall contain a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers, and including, if with respect to significant items in the report covered by the certificate any auditing procedures generally recognized as normal have been omitted, a specific designation of such procedures and of the reasons for their omission; (B) shall state whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances; and (C) shall state whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case.

(3) Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (h) of this rule.

(h) ACCOUNTANT'S CERTIFICATE — OPINIONS TO BE EXPRESSED.—The accountant's certificate shall state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein.

(i) ACCOUNTANT'S CERTIFICATE — EXCEPTIONS.—Any matters to which the accountant takes exception shall be clearly identified; the exception thereto shall be specifically and clearly stated; and, to the extent practicable, the effect of each such exception on the related item of the report shall be given.

(j) (1) If a broker or dealer holding any membership interest in and subject to the capital rules of a national securities exchange whose members are exempt from Rule 15c3-1, by sub-paragraph (b)(2) thereof, ceases to be a member in good standing of such exchange, such broker or dealer shall, within two business days after such event, file with the Commission, as of the date of such event:

(A) A proof of money balances of all ledger accounts in the form of a trial balance;

(B) A computation of aggregate indebtedness and net capital made in accordance with Rule 15c3-1;

(C) An analysis of the aggregate market value of fully paid securities in customers' security accounts not segregated showing the location of such securities;

(D) Ledger net credit balances of money borrowed from banks, trust companies and other financial institutions and from others, which are fully or partially secured by securities carried for the account of any customer, showing, for each loan, an analysis of the market value of all collateral for such borrowings by source of collateral, stating separately the market value of: (a) securities carried for the accounts of customers, (b) securities owned by the broker or dealer or by any general or special partner or any director or officer of such broker or dealer, and (c) any other securities, and

(E) The aggregate amount of customers' ledger debit balances.

The report shall be filed at the Commission's principal office in Washington, D. C. and in duplicate original with the Regional Office of the Commission for the region in which the broker or dealer has his or its principal place of business: Provided, however, that such report need not be made or filed if the Commission, upon written request or upon its own motion exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement. Provided, further, that the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

(2) Attached to the report required by sub-paragraph (1) hereof shall be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the report is true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner, or if a corporation, by the chief executive officer, or in his absence, by the person authorized to act in his place.

(3) For the purposes of this paragraph "membership interest" shall include the following: Full membership, allied membership, associated membership, floor privileges, and any other interest that entitles a broker or dealer to the exercise of any privilege on an exchange.

(A) for the purposes of this paragraph and sub-paragraph (b)(2) of Rule 15c3-1, any broker or dealer shall be deemed to have ceased to be a member in good standing of such exchange when he or it has resigned, withdrawn, or been suspended or expelled from a membership interest in such exchange or has directly or through any associated person sold or entered into an agreement for the sale of a membership interest which would on consummation thereof result in the termination of the broker or dealer's membership interest in such exchange.

(4) Whenever any national securities exchange whose members are exempt from Rule 15c3-1 by sub-paragraph (b)(2) thereof takes any action which causes any broker or dealer which is a member of such exchange to cease to be a member in good standing of such exchange or when such exchange learns of any action by such member or any other person which causes such broker or dealer to cease to be a member in good standing of such exchange, such exchange shall report such action promptly to the Commission, furnishing information as to the circumstances surrounding the event.

(k)(1) ADDITIONAL STATEMENTS TO BE FURNISHED TO THE COMMISSION.—Except for a broker or dealer who comes within subparagraph (k)(2) of this rule, a member, broker or dealer shall, not more than thirty (30) days after the report required by subparagraph (a)(1) hereof is required to be filed, or, in the event of an extension granted under paragraph (d) hereof, not more than 100 days after the date of the financial statements, file with the Regional Office of the Commission for the region in which he has his principal place of business two (2) copies of the statements specified in subparagraph (k)(3) of this rule which shall be deemed confidential.

(2) The requirements of subparagraph (k)(1) shall not apply to a broker or dealer: (A) who is exempt from Rule 15c3-1 under the provisions of subparagraph (b)(3)

thereof, or; (B) whose activities are limited to any combination of the following and which are conducted in the manner prescribed herein:

(i) as introducing member, broker or dealer, the forwarding of all the transactions of his customers to a clearing member, broker or dealer on a fully disclosed basis: *provided that* such clearing member, broker or dealer reflects such transactions on its books and records in accounts it carries in the names of such customers and that the introducing member, broker or dealer does not hold funds or securities for, or owe funds or securities to, customers other than funds and securities promptly forwarded to the clearing member, broker or dealer or to customers;

(ii) the prompt forwarding of subscriptions for securities to the issuer, underwriter or other distributor of such securities and of receiving checks, drafts, notes or other evidences of indebtedness payable solely to the issuer, underwriter or other distributor who delivers the security directly to the subscriber or to a custodian bank, if the broker-dealer does not otherwise hold funds or securities for, or owe money or securities to, customers;

(iii) the sale and redemption of redeemable shares of registered investment companies or the solicitation of share accounts of savings and loan associations in the manner contemplated by the $2,500 minimum net capital requirement of Rule 15c3-1 under the Act or the offering to extend any credit to or participate in arranging a loan for a customer to purchase insurance in connection with the sale of redeemable shares of registered investment companies; and

(iv) conduct which would exempt the broker-dealer from the provisions of Rule 17a-13 by reason of the provisions of paragraph (a) thereof.

(3) The statements to be furnished the Commission in accordance with subparagraph (k)(1) are as follows: a balance sheet based on the report of financial condition required by paragraph (a)(1) of this rule; a statement of income, a statement of source and application funds, a statement of changes in subordinated accounts, and a statement of changes in sole proprietors' capital or the aggregate of partners' capital accounts or each component of corporate stockholders' equity for the period since the date of the immediately preceding report filed pursuant to this rule. The report of a newly registered member, broker or dealer shall cover the period since the date of the statement of financial condition included in the application for registration on Form BD unless such newly registered member, broker or dealer is succeeding to and continuing the business of another member, broker or dealer, in which event the report shall cover the period since the date of the immediately preceding report filed pursuant to this rule by the predecessor member, broker or dealer. The statements required by this paragraph shall be governed as to form and content by Regulation S-X and shall be certified by a certified public accountant or public accountant who shall be in fact independent, unless the member, broker or dealer meets the requirements for exemption from certification in paragraph (b) hereof.

(l) If within 90 days after the close of its calendar or fiscal year a member, broker or dealer files with the Commission certified unconsolidated financial statements which are equivalent to those required by subparagraph (k)(3) of this rule, then such statements may be used in lieu of the statements required in paragraph (k).

(m) STATEMENTS TO BE FURNISHED CUSTOMERS.—Every member, broker or dealer who is subject to paragraph (k) or (l) of this rule shall send to its customers (as defined in paragraph (o) hereof) the following information at the same time as it files with the Commission the information required by paragraph (k):

(1) An unconsolidated balance sheet with appropriate notes including but not limited to the nature, amounts and maturities of subordinated capitalization which shall be certified if the financial statements furnished in accordance with subparagraph (k)(3) are required to be certified.

(2) A statement indicating the amount of the firm's net capital and its required net capital, computed in accordance with Rule 15c3-1 or the net capital rule of the national securities exchange to which the member, broker or dealer is subject, with an explanation thereof;

(3) If in connection with the most recent report on Form X-17A-5 the independent accountant commented on any material inadequacies found to exist in the accounting system, the internal accounting control, procedures for safeguarding securities or the procedures followed in complying with Rule 17a-13 there shall be a statement by the member, broker or dealer that a copy of such report and comments

is currently available for the customer's inspection at his or its principal office and at the principal office of the Commission in Washington, D. C. and the regional office of the Commission in which the member, broker or dealer has his or its principal place of business;

(4) A statement indicating that Part I of the most recent annual report of the member, broker or dealer on Form X-17A-5 is available for examination and copying at the principal office of the member, broker or dealer and at the regional office of the Commission for the region in which the member, broker or dealer has his or its principal place of business.

(n) Every member, broker or dealer who is subject to paragraphs (k), (l) and (m) of this rule shall furnish customers (as defined in paragraph (o) of this rule) and shall file with the Regional Office of the Commission for the region in which the member, broker or dealer has his principal place of business and with the national securities exchange and the national securities association of which he is a member (or, if he is not a member, only with the Commission) not later than 285 days from the date of the audited statements required by paragraph (m) of this rule, an unaudited statement containing the information specified in subparagraphs (m)(1) and (m)(2) of this rule which shall be as of the date of the member's, broker's or dealer's fiscal period which ends nearest to 6 months from the date of the audited statements required to be furnished to customers pursuant to paragraph (m) of this rule.

(o) For purposes of paragraphs (m) and (n) of this rule the term customer includes any person (other than another member, broker or dealer, but including a person who is a customer of an introducing member, broker or dealer who is exempted by clause (b)(i) of subparagraph (k)(2) of this rule), for or with whom a broker-dealer has effected a securities transaction in a particular month, which month shall be either the month of the balance sheet date or a month following the balance sheet date in which the statement is sent and in addition, any person for whom the member, broker or dealer holds securities for safekeeping or as collateral or for whom the member, broker or dealer carries a free credit balance in the month in which customers are determined for purposes of this rule.

18 U.S.C. § 1. Offenses classified

Notwithstanding any Act of Congress to the contrary:

(1) Any offense punishable by death or imprisonment for a term exceeding one year is a felony.

(2) Any other offense is a misdemeanor.

(3) Any misdemeanor, the penalty for which does not exceed imprisonment for a period of six months or a fine of not more than $500, or both, is a petty offense.

18 U.S.C. § 371. Conspiracy to commit offense or to defraud United States

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.

Rule 7(a), Fed. R. Crim. Proc.

Rule 7. The Indictment and the Information

* * *

(c) Nature and Contents.

(1) In General. The indictment or the information shall be a plain, concise and definite written statement of the essential facts constituting the offense charged. It shall be signed by the attorney for the government. It need not contain a formal commencement, a formal conclusion or any other matter not necessary to such statement. Allegations made in one count may be incorporated by reference in another count. It may be alleged in a single count that the means by which the defendant committed the offense are unknown or that he committed it by one or more specified means. The indictment or information shall state for each count the official or customary citation of the statute, rule, regulation or other provision of law which the defendant is alleged therein to have violated.

(2) Criminal Forfeiture. When an offense charged may result in a criminal forfeiture, the indictment or the information shall allege the extent of the interest or property subject to forfeiture.

(3) Harmless Error. Error in the citation or its omission shall not be ground for dismissal of the indictment or information or for reversal of a conviction if the error or omission did not mislead the defendant to his prejudice.

No. 75-1630

In the Supreme Court of the United States

OCTOBER TERM, 1976

CARL W. ANDERSON, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,

RICHARD L. THORNBURGH,
Assistant Attorney General,

RICHARD R. ROMERO,
Attorney,
Department of Justice,
Washington, D.C. 20530.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) is not yet reported. The opinion of the district court (Pet. App. 18a-21a) is reported at 399 F. Supp. 982.

JURISDICTION

The judgment of the court of appeals was entered on March 8, 1976. A petition for rehearing was denied on April 7, 1976. The petition for a writ of certiorari was filed on May 7, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the conspiracy offense of which petitioner was convicted is punishable by imprisonment.

2. Whether the indictment properly alleged a conspiracy to violate 15 U.S.C. 78q(a) and 78ff(a).

3. Whether the delay prior to indictment amounted to a denial of due process.

4. Whether the prosecution was obliged to present to the grand jury evidence allegedly contradicting the testimony of another grand jury witness.

5. Whether there was sufficient evidence to support petitioner's conviction for conspiring to make false statements in a report filed with the Securities and Exchange Commission.

STATEMENT

Following a jury trial in the United States District Court for the Southern District of New York, petitioner was convicted of having conspired to file with the Securities and Exchange Commission an "X-17A-5" questionnaire falsely listing the accounts of the Orvis Brothers brokerage firm and its customers and falsely stating that an improper hypothecation of fully paid customers' securities had been corrected.[1] He was sentenced to imprisonment for one year and one day. The court of appeals affirmed (Pet. App. 1a-17a).

While petitioner was a general partner in the Wall Street brokerage firm of Orvis Brothers[2] and during his tenure as chairman of its executive committee, petitioner conspired with fellow partners Fergus M. Sloan, Donald Eucker, Thomas C. Kilduff, and others to conceal the weakened financial condition of the firm and thereby to

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[1]The indictment charged Donald Eucker, Fergus M. Sloan, John J. Villani, and Thomas Kilduff with conspiring with petitioner to file false statements with the Commission. Eucker and Sloan pleaded guilty. Kilduff pleaded guilty and testified for the government at petitioner's trial. The jury acquitted Villani.

[2]Petitioner had invested over $1,000,000 in the firm (Tr. 14, 107-108, 141, 1516).

keep the firm operating long after it lacked the necessary capital to do so. Under Rule 325 of the New York Stock Exchange, Orvis's liabilities could not exceed twenty times its capital. For a violation of the Rule, the Exchange could have ordered Orvis to cease doing business or could have placed restrictions on its operations (Tr. 151). Petitioner and his co-conspirators sought to avoid these sanctions by filing a false financial report with the Commission. In June 1970, Orvis Brothers was nevertheless unable to stay in business; it closed its doors, leaving debts in excess of four million dollars.

The evidence showed that Orvis was experiencing financial difficulties in the fall of 1968 and 1969 and needed to raise additional capital (Tr. 149). During a March 1969 executive committee meeting (which petitioner and Eucker attended), Sloan, the managing partner, told Kilduff, who was in charge of finance accounting, to add $797,100—due as commissions but yet unpaid—to the firm's profit and loss statement and to place 4,000 shares of Clinton Oil in the firm's trading account without posting their cost. Petitioner did not object to these measures, which inflated the firm's capital (Tr. 190-191, 267-268).

At another meeting in April 1969, Kilduff mentioned his attempt to "prop up" the firm's capital by fraudulent bookkeeping, and advised the partners that the firm's untampered capital ratio was 30 to 1 (Tr. 208). Petitioner and Sloan told Kilduff: "Just make sure we stay in business, we keep the doors open" (Tr. 209). At an August 1969 executive committee meeting, Kilduff told petitioner and the other partners that another 5,000 shares of Clinton Oil were listed as firm capital without the posting of their cost and that four bad debt accounts were posted as cash accounts although they should have been charged against the firm's capital (Tr. 289-290, 309-310).

In August 1969, Realto Clinton sent Lyndon Gamelson to Orvis in connection with Sloan's request that Clinton invest additional capital in the brokerage firm (Tr. 1160, 2190). Petitioner told Gamelson that there was no problem with the firm's capital ratio, reassured him in a "half-dozen ways," and returned to Gamelson stock that Gamelson had invested in the firm—telling him that Orvis did not need it (Tr. 1164, 1255).

Throughout 1969, Eucker—a member of the executive committee—instructed Orvis employees to hypothecate customers' securities for which the customers had fully paid (Tr. 1129, 1934).[3] Orvis used these securities, which it held for safekeeping, as collateral to secure bank loans; the proceeds of the loans were added to the firm's capital account (Tr. 1126-1128). Securities worth more than $5,960,000 were hypothecated (Tr. 1337-1338, 1392).

On October 15, 1969, petitioner attended a meeting at which the firm's auditors reviewed—question by question—the X-17A-5 report on Orvis's financial status. The auditors prepared the report from the figures in Orvis's books (Tr. 412, 1322-1324). The X-17A-5 report stated, among other things, that Orvis had pledged "in error" fully paid customers' securities, totaling in excess of $5,960,000, but that the situation had been "corrected" by substituting different securities that were not fully paid for (Tr. 1337-1338, 1392). Orvis filed the report with the SEC on October 16, 1969.

ARGUMENT

1. The conspiracy statute under which petitioner was convicted,' 18 U.S.C. 371, provides a maximum penalty

[3]Hypothecation is the giving of a security interest in property to a creditor without delivery of possession or transfer of title to the creditor. See *The Nestor*, 18 Fed. Cas. 9 (No. 10,126).

of five years' imprisonment or a fine of $10,000, or both; but if the object of the conspiracy is a misdemeanor, the penalty may not exceed the maximum penalty for that misdemeanor. Petitioner argues (Pet. 17-25) that the object of the conspiracy here was a misdemeanor for which no term of imprisonment was authorized and, accordingly, that his sentence of imprisonment for a year and a day was improper.

Petitioner's argument rests on the provision of 15 U.S.C. 78ff(a) that a term of imprisonment may not be imposed for violating an SEC rule or regulation of which the defendant had no knowledge. Claiming that he was convicted of conspiring to violate Rules 17a-3, 4, and 5, 17 C.F.R. 240.17a-3 to 240.17a-5 (requiring the filing of X-17A-5 questionnaires), rather than of conspiring to make false statements, in violation of 15 U.S.C. 78q(a) and 78ff(a), petitioner asserts: (1) that no term of imprisonment could properly have been imposed for the substantive offense because he lacked knowledge of the SEC rules, (2) that the substantive offense, punishable by a fine, was only a misdemeanor under 18 U.S.C. 1, and (3) that his conviction therefore subjected him only to a fine and not to a term of imprisonment.

The flaw in petitioner's argument is his premise that he was convicted of conspiring to violate the SEC rules rather than the statutory prohibitions. The object of the conspiracy, as charged in the indictment and proved at trial, was to submit false statements to the SEC and thereby to conceal Orvis's financial problems. SEC Rules 17a-3, 4, and 5 required the filing of the relevant X-17A-5 questionnaire and specified the information to be disclosed. But it was 15 U.S.C. 78ff—not the rules—that prohibited the making of false statements. As the court of appeals correctly stated (Pet. App. 11a-12a):

> The charge of wrongdoing submitted to the jury was not the failure to keep and preserve records and file reports as required by the rules; it was the making of false and misleading statements in a report, which conduct was specifically proscribed by §78ff(a). [Petitioner] is therefore not entitled to rely on the "no knowledge" portion of that statute. *United States* v. *Colasurdo, supra,* 453 F. 2d [585] at 594 [(C.A. 2)].

2. Petitioner asserts (Pet. 25-34) that the indictment did not properly charge a conspiracy to hypothecate customers' securities, in violation of SEC Rule 8c-1, 17 C.F.R. 240.8c-1, because it failed to allege that the amount hypothecated exceeded the aggregate indebtedness of all of Orvis's customers. But the indictment, as submitted to the jury, did not purport to charge an unlawful hypothecation. The district court did not submit to the jury Count 9, charging an hypothecation in violation of Rule 8c-1 (Tr. 983).[4] The only relevance of the hypothecation to the indictment as submitted to the jury was that the conspiracy count alleged that the X-17A-5 questionnaire falsely stated that Orvis Brothers had corrected an erroneous hypothecation of $5,960,000 worth of customers' fully paid securities (C.A. App. 25a).[5]

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[4]The court, before submitting the case to the jury, dismissed Count 9, charging petitioner and his co-defendants with an hypothecation in violation of 15 U.S.C. 78h and 78ff, 18 U.S.C. 2, and 17 C.F.R. 240.8c-1. The court stated that it was doing so to simplify the case and that the count might properly have been submitted to the jury (Tr. 982-983, 2310-2312).

[5]In Count 1 under the indictment's original format, a paragraph—not submitted to the jury—charged that an object of the conspiracy was the hypothecation of customers' securities (C.A. App. 10a, 24a-25a). ("C.A. App." refers to the appendix in the court of appeals).

The district court emphasized, in its final instructions to the jury, that the government did not contend that the defendants intended improperly to hypothecate customers' securities; rather, the court said, the issue was whether the defendants "misrepresented their efforts to correct the [erroneous hypothecation], thus contributing to the claimed falsity of the questionnaire" (Tr. 3040-3041). Thus, as the court of appeals correctly held (Pet. App. 10a):

> Whether, as [petitioner] now asserts, the Government failed to prove that the hypothecation was unlawful is beside the point; the SEC was entitled to truthful information. The wrongful act charged was the filing of the false report, not the hypothecation.

3. Petitioner's contention (Pet. 35-42) that he was denied due process because of pre-indictment delay was waived by his failure to raise the issue before trial. As the court of appeals stated, "[a] defendant cannot wait to see whether the verdict is to his liking before arguing that he was prejudiced by delay" (Pet. App. 10a). See Rule 12(b)(2), Fed. R. Crim. P.; *Estrella* v. *United States,* 429 F. 2d 397 (C.A. 9), certiorari denied, 400 U.S. 1011. In any event, petitioner was not denied due process by the filing of the indictment on September 10, 1974—charging a conspiracy beginning on September 1, 1968—since petitioner did not incur substantial, actual prejudice, nor did the government intend to gain a tactical advantage from the delay. *United States* v. *Marion,* 404 U.S. 307, 324.

Petitioner contends that the delay deprived him of the testimony of Robert Vesco, who in 1972 testified before the SEC in its investigation of the Orvis collapse. But petitioner does not allege—and the record does not show—that Vesco's testimony would have aided petitioner's defense. Petitioner also asserts that the delay made it

impossible to obtain alibi witnesses and that the memories of witnesses faded, but these generalized claims do not demonstrate that petitioner was denied a fair trial and do not justify dismissal of the indictment. *United States* v. *Marion, supra,* 404 U.S. at 326. As the court of appeals found, petitioner has "failed to show any contrived procrastination by the Government and [can] point to no prejudice established beyond mere conjecture" (Pet. App. 10a).

4. Petitioner argues (Pet. 36-38) that he was denied his "right to indictment" by the grand jury because the government did not call Peter Schmidt[6] before the grand jury. The government, however, is not obliged to call all available witnesses before the grand jury and need not present evidence tending to weaken its case. *United States* v. *Koska,* 443 F. 2d 1167, 1169 (C.A. 2), certiorari denied, 404 U.S. 852.[7] In any event, there is no reason to suppose that the grand jury would have been any more influenced by the testimony than was the petit jury at trial.

5. Petitioner contends (Pet. 42-43) that there was insufficient evidence to sustain his conviction for conspiring to make false statements in the X-17A-5 questionnaire filed with the SEC. That contention was correctly

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[6]Schmidt, Kilduff's attorney, testified at trial that Kilduff had told him that he acted alone in falsifying the firm's books and that his partners knew nothing about it (Tr. 2460).

[7]Petitioner's reliance (Pet. 37) on *Johnson* v. *Superior Court of San Joaquin County,* 15 Cal. 3d 248, 124 Cal. Rptr. 32, 539 P. 2d 792, is misplaced. There, an indictment was dismissed because the grand jury was not given exculpatory evidence, in violation of a specific provision of the California Penal Code that requires a grand jury to hear such evidence. There is no comparable federal statute, nor has such a requirement been imposed by any federal court.

rejected by the court of appeals on the basis of its own thorough review of the evidence (Pet. App. 8a-9a). Further review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ROBERT H. BORK,
Solicitor General.

RICHARD L. THORNBURGH,
Assistant Attorney General.

RICHARD R. ROMERO,
Attorney.

JULY 1976.